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PART II

OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

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POLICIES FOR ACQUIRING COMMERCIAL OR INDUSTRIAL PRODUCTS AND SERVICES FOR GOVERNMENT USE

Proposed Policy Issuance; Invitation for Public Comment

[3110-01]

OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

POLICIES FOR ACQUIRING COMMERCIAL OR INDUSTRIAL PRODUCTS AND SERVICES FOR GOVERNMENT USE

Proposed Policy Issuance; Invitation for Public Comment

AGENCY: Office of Federal Procurement Policy, Office of Management and Budget.

SUMMARY: This proposed cost comparison handbook (enclosed) would supplement OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services for Government Use." It provides comprehensive guidelines for agencies when they conduct a comparative cost analysis to determine whether a particular product or service could be provided more economically by the private sector or by use of Government employees. These guidelines should assure greater accuracy, equity, and consistency in such cost analyses and contribute significantly to improved implementation of Circular A-76.

DATE: Comments must be received on or before November 15, 1978.

ADDRESS: Comments should be addressed to the Administrator for Federal Procurement Policy, Office of Management and Budget, 726 Jackson Place NW., Washington, D.C. 20503.

FOR FURTHER INFORMATION CONTACT:

Mr. William D. Russell, Deputy Assistant Administrator for Logistics, telephone 202-395-3327.

SUPPLEMENTARY INFORMATION: In the comprehensive review of OMB Circular A-76 which preceded the current revision of that circular, one of the major deficiencies noted in implementation was inaccurate, incomplete, and inconsistent cost analyses used to support both in-house and contract performance. The proposed revisions to Circular A-76, which were published for comment in November 1977, included a proposal for a detailed cost comparison handbook. This proposal was strongly endorsed by a broad range of interests responding to the notice, including Federal employee unions, private firms and associations, and Members of Congress.

This draft handbook was prepared by an interagency work group consisting of cost accounting experts from the Departments of Defense and Energy, the General Services Administration, and Veterans' Administration, and an adviser from the General Accounting Office. It is offered for review and comment by all interested parties to insure that the final version is clear, comprehensive, and adequate to insure satisfactory results.

LESTER A. FETTIG,
Administrator.

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CHAPTER I - GENERAL

Introduction

This Cost Comparison Handbook implements the cost comparison principles contained in OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services for Government Use." Official use of this Handbook is prescribed in OMB Circular A-76, which directs Federal agencies to ensure that their comparative cost analyses are made in conformity with these guidelines.

Purpose

The purpose of this Handbook is to provide a detailed, simplified guide for developing comprehensive cost estimates. Such information is necessary for a valid comparison of the estimated cost to the Government of acquiring a product or service by contract or by providing it with Government in-house resources. In addition to assisting agencies in developing comprehensive cost estimates, the Handbook is intended to establish consistency, assurance that all substantive factors are considered when making cost comparisons, and a desirable level of uniformity among agencies in the handling of this determinative process.

Background

The American taxpayers have a right to expect economical performance of Federal activities. In some instances, these activities must be performed by Federal employees. In many other instances, however, they may be performed either by contractors or by Federal employees. That choice must be determined by a finding as to whether contract or in-house performance would be more economical.

Government reliance on the private sector was first enunciated by the executive branch as a general policy in 1955. Since then Federal agencies have struggled to make rational judgments as to the cost considerations that should be included in a comparative analysis to establish whether the Government's interest would be served best by contract or in-house performance. Assistance was provided by OMB Circular A-76, initially issued on March 3, 1966 and revised August 30, 1967, which contained guidelines for agencies in making those analyses.

As Government cost accounting techniques progressed, it became obvious that Circular A-76 guidelines were too general to achieve desirable uniformity, and were

insufficient as a basis for comprehensive cost studies. The need for more precise guidance in developing cost estimates and for cost comparative analyses was the most prevalent suggestion made when agency and public comments were invited for consideration in a review and subsequent revision of Circular A-76. The proposed solution, a detailed cost comparison handbook, was widely and strongly supported by the numerous respondents to OMB's request for comment on the proposed changes to Circular A-76 in November 1977.

Development of Handbook

This Handbook has been developed to provide step-by-step guidance for making a cost comparison analysis. The Handbook is addressed to readers who are not cost accountants and who may not have access to the advice of a cost accountant. The simplified guidance employed in the Handbook is not so much designed to make a difficult task easy as it is to make a complicated task understandable -- and doable by persons without prior experience in cost accounting. Such technical advice as may be needed should be available from Government financial management or comptroller personnel.

The first and most important step in making a cost comparison analysis is the development of the work statement. Chapter III explains the importance of this effort and the steps necessary to its preparation. It also explains the process by which the in-house cost estimate is placed in competition with contractor bids.

The principal chapters of the Handbook describe the steps necessary to develop entries for each of the lines on the Cost Comparison Form (Exhibit 1) and the Decision Summary Form (Exhibit 2). The location of these forms in the Handbook corresponds with their place as the end objective of every cost comparison study. The forms also serve to organize the Handbook in that each of the cost analysis chapters and sections is keyed to a line entry on the Cost Comparison Form.

The Glossary of Terms, included as an appendix, contains definitions which are consistent with those generally accepted in the cost accounting community.

CHAPTER II - POLICY

Under certain circumstances, a Government agency is authorized by OMB Circular A-76 to establish in-house capability or to continue an existing activity to provide a product or service that is obtainable from a private source. One justifying circumstance is when a comparative cost analysis, prepared as provided in this Handbook, indicates that the Government's cost would be lower than if the product or service were obtained from a commercial or other non-Federal source. Detailed guidelines for making these cost comparisons are set forth in this Handbook for application by all Federal agencies. The guidelines are based on the following policy principles:

Common Ground Rules

a. Both Government and commercial cost figures must be based on the same scope of work and the same level of performance. This requires the preparation of a sufficiently precise work statement with performance standards that can be monitored for either mode of performance.

b. Standard cost factors will be used as prescribed by the Cost Comparison Handbook and as supplemented to accommodate particular agency operations. It will be incumbent on each agency to defend any variations in costing from one case to another.

c. All significant Government costs must be considered, both for administering a contract and for direct Government performance, including allocation of indirect (overhead) costs.

d. The base period for the cost analysis will be keyed to the expected span of performance to guard against "buy-in" pricing on the part of contractors or Government activities. Prepriced options and subsequent recompetition should also be used to avoid a contract "buy-in." Except when the circumstances of the requirement dictate otherwise, the base period will correspond to the period of the proposed contract, including options.

e. Cost comparisons are to be aimed at full cost, to the maximum extent possible in all cases.

f. Ordinarily, agencies should not incur the delay and expense of conducting cost comparison analyses to justify a Government commercial or industrial activity for products or services estimated to cost the Government less than $100,000 per year. However, if there is reason to believe that inadequate competition or other factors are, causing commercial prices to be unreasonable, a cost comparison analysis can be conducted. Reasonable efforts should first be made to obtain satisfactory prices from existing commercial sources and to develop other competitive commercial sources.

g. The cost comparison will use the present value cost and discount rate prescribed in OMB Circular No. A-94, "Discount Rates to be Used in Evaluating Deferred Costs and Benefits," when there are significant differences in capital investment or in the timing of outlays.

Calculating Contractor Costs

The commercial cost figure must be based on a firm bid or proposal, solicited in accordance with pertinent procurement regulations. Bidders must be told that an in-house cost estimate is being developed and that a contract may or may not result, depending on the comparative cost of the alternatives.

Calculating Costs of Government Operation

a. Each agency should assure that Government operations are organized and staffed for the most efficient performance. To the extent practical and in accordance with agency manpower and personnel regulations, agencies should schedule reviews under this Circular with internal reorganizations for accomplishing the work most efficiently.

b. The Government cost factor for Federal employee retirement benefits, based on a dynamic normal cost projection for the Civil Service retirement system, will be 20.4%.

c. The Government cost factor for Federal employee insurance (life and health) benefits, based on actual cost, will be 4%.

Other Requirements

a. An existing in-house activity will not be converted to contract performance on the basis of economy unless it will result in savings of at least 10% of the estimated Government personnel costs.

b. A "new start" will not be approved on the basis of economy unless it will result in savings compared to contract performance at least equal to 10% of Government personnel costs, plus 25% of equipment and facility costs.

c. All cost comparisons must be reviewed by a qualified activity independent of the cost analysis preparation to ensure conformance to the instructions in the Cost Comparison Handbook.

CHAPTER III - PREPARATION FOR COST ANALYSIS

General

A valid comparative cost analysis under Circular A-76 requires an accurate determination of the costs of acquiring the needed products or services from the private sector and from the existing or proposed Government commercial or industrial activity. To ensure an equitable comparision, both cost figures must be based on the same scope of work, and include all significant identifiable costs that would be incurred by the Government under either alternative.

Initial Planning

The comparative cost analysis and implementation of the conclusions reached involve the responsibilities of many functional and staff offices of the agency. For best coordination of these responsibilities, a task group should be formed by representatives of the various organizations and offices concerned, such as: the functional or operational organization, the manpower and/or personnel office, the finance and accounting office, the management analysis group (if available), the budget office, the procurement office, the legal office, and other staff functions as appropriate. The task group leader should be thoroughly familiar with this Handbook.

This group should establish a plan and time schedule for orderly completion of the necessary steps to conduct the study and reach a timely conclusion to either award a contract or to continue or initiate the Government commercial or industrial activity. The schedule should allow adequate time for preparation of a comprehensive work statement, solicitation of bids or proposals, determination of in-house costs, evaluation of bids and the Government estimate, the independent audit, and review and approval of the conclusions. In this regard, close coordination with the procurement office and the personnel office is required to ensure compliance with procurement regulations and to provide maximum consideration for Government personnel who would be displaced in the event of a conversion from in-house to contract performance.

Preparation of Work Statement

The preparation of the work statement is a critical step; it must be comprehensive enough to ensure that performance by contract or in-house will satisfy the Government requirement. It must also serve as the basis for estimating both the contract and Government cost, to ensure comparability and equity in the cost analysis. The work statement should clearly state what is to be done without prescribing how it is to be done. It should also provide performance standards to ensure a comparable level of performance by both alternatives and to provide a basis for evaluation. Maximum flexibility should be permitted in staffing to permit each potential performer to propose the most efficient approach consistent with his organization and resources.

The work statement should describe all duties, tasks, responsibilities, frequency of performance of repetitive functions, and requirements for furnishing facilities and materials. Where the workload is variable, historical data for a representative period on workload, material and parts consumption, etc. will be provided, when available, along with the best estimate of future requirements. Bid solicitations will normally call for use of contractor facilities, unless performance on Government property is essential or would be more economical. When the work is currently being performed in a Government-owned facility or appropriate Government facilities are available, and contractor use of those facilities would be in the Government's interest, bids will be requested on that basis. Requirements regarding the proximity of the contractor's facility to the Government installation will be used only when clearly justified in terms of operational necessity to meet Government needs.

The work statement will be reviewed by the contracting officer to ensure that it is adequate and appropriate for a contract specification. The contracting officer will be responsible for advertising the requirement, through the Commerce Business Daily and by other means, but the functional organization will identify any known commercial sources -- this is particularly important in the case of unique products or services which have not been previously procured commercially.

Procedure

When the statement of work has been prepared and approved, firm bids or proposals will be solicited. Formal advertising, with firm fixed price bids, will be used when appropriate for the requirement. Proposals may be requested for competitive negotiations when this method would be more suitable and warranted under current procurement

regulations. Concurrent with the procurement procedure, the in-house cost estimate will be prepared, based on the same work statement that is used in the contract solicitation. If the Government staffing plan differs from the existing Government activity, it must be consistent with agency manpower and personnel regulations and must be implemented within 60 days following a determination to continue Government performance.

The in-house cost estimate will be completed and submitted to the contracting officer three days prior to opening of bids or completion of negotiations. Confidentiality of both the in-house estimate and contract prices will be maintained to ensure that they are completely independent.

The contracting officer will determine the lowest acceptable contract price, conducting preaward surveys as required to establish the lowest responsible and responsive bidder. When the proposed contract would contain flexible pricing provisions, the criteria for incentive or award fees are critical to the determination of the proper amount to be entered as the contract price. Use of the maximum incentive or award fee available would be inappropriate because it would reflect a different standard of performance from the level which provided the basis for the in-house cost estimate. It is essential that the invitation for bid or proposal provide for a common standard of performance to permit an equitable comparison of Government and contract costs for performing the same task.

When the Government and contract costs are established, the Cost Comparison Form can be completed, adding the Government costs for awarding and administering the contract and applying the appropriate cost differntial and and other considerations as provided in Chapter VI. The comparison must then be reviewed for conformance with this Handbook by a qualified party independent of the cost analysis preparation; e.g., the agency independent audit function. The results of the cost study will then be announced and the detailed analysis will be made available to any interested parties -- bidders, affected employees, and unions representing affected employees. If no significant discrepancy in the cost comparison is reported within five working days after the announcement, a contract will be awarded or the procurement action will be cancelled, as appropriate.

When a discrepancy is found in the cost analysis, every effort will be made to correct it in a time frame that corresponds to the requirement and the validity date of proposals. If the analysis is for a new start, and there is a serious defect in the in-house cost estimate, the in-house figure will be rejected and a contract will be awarded. When the analysis concerns a Government commercial or industrial activity, and the discrepancies cannot be corrected within the validity date of prposals, the procurement action may be terminated and the review rescheduled.

CHAPTER IV - DEVELOPING AN ESTIMATE OF GOVERNMENT COSTS

GENERAL

In order to develop the estimated cost to the Government for producing a product or performing a service, it is necessary to accumulate the various elements of direct and related indirect costs. The Cost Comparison Form shown as Exhibit 1 will be used for this purpose. In the following sections, definitions of the cost elements contained in this form are presented. Also included are instructions on how to estimate the amount to be included in each cost element, and on the data needed to support the estimates.

To the extent practical, the cost accounting standards published by the Cost Accounting Standards Board have been used as guides for classifying costs by elements and for distinguishing between direct and indirect costs. The following definitions, based upon Title IV, Code of Federal Regulations, Chapter III, Subchapter G, Part 400, are particularly pertinent to these determinations:

Cost Objective. A function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

Final Cost Objective. A cost objective which has allocated to it both direct and indirect costs, and, in the cost accumulation system, is one of the final accumulation points.

Direct Cost. Any cost which can be identified specifically with a particular final cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs which can be identified specifically with a product/service are direct costs of that product/service. All costs identified specifically with other products/services are direct costs of those products/services.

Indirect Cost. Any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

It is important that the basic principles contained in the above definitions be understood to preclude the possibility of "double counting" in preparing the estimate of the Government's costs. "Double counting" results when certain costs are treated as direct costs of the product/service, while similar costs related to other products/services are treated as indirect costs and a portion thereof is also allocated to the product/service for which the estimate is being prepared. A common instance of "double counting" is the treatment of travel costs. All travel is considered as an indirect cost in typical accounting systems. However, when estimating the cost of an activity being reviewed for contracting out, the travel required of personnel whose time is accounted for as direct labor can easily be allocated to the activity under review. Since the travel costs of personnel whose time is accounted for as direct labor working for other activities is treated as indirect costs, a portion of such travel will be allocated to the activity under review. This is "double counting." The correct approach is to treat all travel as indirect costs, or to change the accounting system so that all travel costs of all personnel whose time is accounted for as direct labor are allocated as direct costs to the activities charged for the direct labor costs.

The application of these principles is demonstrated, and clarified, in the following sections.

MATERIAL COSTS

Direct Material

Direct material includes the costs of such goods as raw material, parts, subassemblies, components and supplies which are identified specifically with the product/service (the final cost objective) under review. In additon, the cost should be significant enough in amount to warrant its inclusion as a direct cost. Nominal material costs should be classified as indirect costs and allocated to applicable final cost objectives. Thus, direct material should have three general characteristics:

a. They should be essential to the performance of the service or necessary to the production of the product;

b. Their quantity and price should be significant; and

c. measurement of their quantity and cost should be relatively easy and inexpensive.

The estimate of direct material costs begins with a thorough review of the specifications for the job to be performed or the product to be funished by the activity under review during the specified time period. Available material usage information and bills of material;i.e., a detailed listing of material for the same or similar jobs requirements and/or products will be used to estimate direct material quantities needed. Changes in the specifications between the past and proposed work effort need to be taken into consideration. Provision needs to be made for overruns, scrap, spoilage and defective work. Thus, the estimated quantity of direct materials to be costed may exceed the minimum quantity determined from the specifications or bills of material. A detailed listing of the kind of direct materials to be used by the activity under review will be developed.

Direct material costs are determined by multiplying the quantities of direct materials by the unit prices. Unit prices will be derived from current cost records to the extent they are available and applicable to the activity under review. Current costs need to be adjusted to give effect to price level changes applicable to the future periods for which the estimate is being made. If current cost records cannot be used, the supply activity (inventory control point) can estimate issue prices for its inventory and General Services Administration or other suppliers' catalogs can be used for non-stocked material. Recent purchase prices of similar items can also be used. The procurement office (purchasing department) can be asked to help estimate the purchase price of special or unusual direct material items. When purchase prices are entirely uncertain and time permits, quotes may be be obtained from potential suppliers. Specific guidance on the pricing of GSA material is presented below.

Pricing of GSA Material

In most instances, the prices charged by GSA for material do not include all the costs of the acquisition and storage functions performed by GSA. Since inclusion of these costs in GSA prices is currently prohibited by law it will be necessary to adjust GSA prices for purposes of Circular A-76 cost estimates. Following is a description of the material supply services provided by GSA together with mark-up rates to be applied to GSA prices to show full costs:

Wholesale and Stores Direct Delivery. This program area involves the distribution of common-use, commercially available items, to agency requisitioners worldwide, through a network of supply distribution facilities located throughout the United States. Also included is the Stores Direct Delivery Program which is designed to provide customers with the same type of items carried in stock which, because of volume orders, are procured from the vendor for direct delivery to the requisitioner in instances when delivery time is not critical.

Retail. The Retail Program provides the agency requisitioner with high demand common-use office and janitorial requirements from retail outlets located in areas of concentrated Federal activity.

Nonstores Direct Delivery and Competitive Federal Supply Schedules. This program is concerned with obtaining customer nonstock requirements through direct shipment from the vendor. Presently, agencies are ordering directly from vendors using schedules established by the GSA Federal Supply Service. Agencies pay the vendors directly for goods and services obtained.

The results of a GSA study disclosed the following add-ons to GSA material prices which must be applied to show the full cost to the Government for purposes of Circular A-76 cost studies:

Wholesale and Stores Direct Delivery	- 21%
Retail	- 36%
Nonstores Direct Delivery and Competitive Federal Supply Schedules	- 5%

Documentation

The backup for the amount shown as direct material costs must be supported by a detailed listing of all the items needed with quantities, unit prices, suppliers, details of adjustments and the source of the information. See Figure 1.

FIGURE 1.

Estimate of direct material for the review of contracting-out activity, _____:

Item Nomenclature (1)	National Stock Number (2)	Quantity: Quantity per Bill of Mat. or Specifications (3)	Quantity: Adjust.1/ (4)	Quantity: Final Est. Quantity (5)	Cost: Unit Purchase Price (6)	Cost: Source of Unit Price (7)	Cost: Adjust.1/ (8)	Cost: Final Est. Unit Price (9)	Direct Material Cost (5)X(9) (10)	Source of Supply (11)
Widget	6730001161618	120	30 a/	150	$11.00	GSA Cat.c/	.55 b/	$11.55	$ 693.00	GSA
Socket	None	60	5 a/	65	15.00	Pur. Dept.	.75 b/	15.75	1,023.75	PM, Inc.
Frontam	3760008161611	500	50	550	57.00	Inventory	3.30 b/	60.30	33,165.00	ABC Corp.
TOTAL COST									$34,881.75	

NOTE: 1/ Explain basis for adjustment.
a/ Normal spoilage.
b/ Estimated price change.
c/ Price list dated October 1, 1978.

In developing the cost of direct material, it is important to know how the cost of the material was determined. That is, does it include such items as transportation, procurement, storage, etc. This determination is essential to the proper application of material overhead costs as defined in the following paragraphs.

Material Overhead

In addition to the direct cost of material, the costs of material overhead -- acquiring, handling, and controlling material -- must also be included in the Government's cost estimate. Since, in most cases, it is not practical to ascertain the costs of these activities as they relate to each item of material, the related expenses should be accumulated in an indirect cost pool (intermediate cost objective) and allocated to the service/product being estimated. Brief descriptions of the functions, the costs of which are to be added to the basic material cost, are presented below:

Acquiring. Includes the efforts related to the determination of material needs, ordering, and/or purchasing material and immediate supervision of such efforts. It also includes the incoming transportation cost of the material.

Handling. Encompasses the efforts related to the physical receipt, storing, and issuing or otherwise disposing of tangible material. Included in these efforts are receiving and inspection activities, care in storage, preservation and depreservation efforts, assembly or disassembly of "sets" and "kits," and the immediate supervision of such efforts.

Controlling. This administrative function relates to the overall acquisition, handling, and distribution process and involves the monitoring of these functions. It also includes the keeping of inventory records of material on hand or on order, and the taking of physical inventories.

The costs to the Government of certain of the above functions may already be included in the price that is paid for the material. For example, the cost of material acquired from Defense stock funds generally includes the incoming transportation costs as well as a surcharge to cover estimated net stock losses on current procurements due to pilferage, damage, deterioration, physical inventory

shortages and excess arising from obsolescence and other causes. Accordingly, as mentioned in the DIRECT MATERIAL section above, it is important to ascertain the makeup of the price paid for material to preclude double costing.

The prices charged for material sold by one Government agency to another should include all significant identifiable direct and indirect applicable costs unless exempted by law. This is in accordance with Comptroller General Decision B-136318, which states in pertinent part: "Effective compliance with the reimbursement provision of 31 U.S.C., paragraph 686(a) is only achieved when all significant elements of cost are recognized and recovered in any transaction under that section. If overhead expense is significant, then like other elements of costs, it should be recognized and recovered." Accordingly, for the most part, and with the exception of GSA, as noted in the DIRECT MATERIAL section, it can be assumed that the price paid for material acquired from other Government agencies and outside vendors will include all of their costs. Under these circumstances, only those costs incurred by the acquiring agency in accomplishing the acquiring, handling, and controlling functions need be added to the material costs.

Within the acquiring agency, it will be necessary to ascertain the costs of the above functions and allocate them to the using activities on the basis of a beneficial or causal relationship. For those agencies which conduct a significant amount of interagency material transfer, appropriate rate data should be readily available in view of the above-mentioned Comptroller General's decision. For those agencies which have not developed appropriate overhead rates, the following guidance is presented.

Anticipated costs specifically identified with the functions of acquiring, handling and controlling material will be determined for the period of performance of the activity being reviewed. Costs specifically identified with the functions include assigned personnel and materials or supplies and equipment used to perform the function as well as related occupancy costs. Purchased services may also be specifically identified with the functions; for example, special tests as part of inspections of the material upon receipt or while in storage to assure acceptability and continued usability. Supervision and other indirect costs applicable to the functions will also be included.

All other costs which measurably benefit or are caused by the functions will be allocated to them. Among these should be the costs of central purchasing, requisitioning and accounting for the activity's materials. The allocation of centralized activities is discussed further under the GENERAL AND ADMINISTRATIVE COSTS section of this Handbook.

A detailed listing of the material overhead costs will be prepared and the total of such costs shown. Figure 2 is an example of such a listing. Supporting documentation for the amounts shown should be either attached to the listing or a reference made to where such data can be examined.

After the total amount of the material overhead costs is determined, it will be necessary to allocate a portion of it to the function being costed. In most cases, an equitable allocation of these costs to the function being priced can be obtained by application of a developed rate to the material costs. As illustrated in Figure 2, a material overhead rate can be developed by dividing the total material overhead expenses by the total material costs; i.e., the allocation base. It is to be noted that this base is the total for all products/services and indirect material and supplies of the entity; not just for the activity under review.

As illustrated above, the use of total material cost as the allocation base is advocated except in those situations where a specific function's beneficial or causal relationship to goods or services produced may be significantly better measured by a physical characteristic of the direct material used such as quantity, weight, or volume. Similarly, the use of one indirect cost pool for material overhead is advocated unless its use would significantly distort the resultant allocations. When material acquired from GSA is included in material costs, the additive factors as presented in the DIRECT MATERIAL section for GSA-furnished material should be added thereto as a cost, and included in the total material costs used to determine the rate.

FIGURE 2
MATERIAL OVERHEAD

Description	Estimated Cost For the Period Ending
Salaries and Wages	
Labor	$ XXX,XXX
Fringe Benefits on above	XX,XXX
Travel	XX,XXX
Operating Supplies	XX,XXX
Maintenance	XX,XXX
Stationery, Printing & Office Supplies	XX,XXX
Utilities	XX,XXX
Depreciation	XX,XXX
Rent (SLUC)	XX,XXX
Allocated Amounts of Centrally Performed Functions1/	
Purchasing	XX,XXX
Requisitioning	XX,XXX
Accounting	X,XXX
Others (list separately)	X,XXX
Total Material Overhead Expense (A)	XXX,XXX
Total Material Costs (B)	XX,XXX,XXX
Material Overhead Rate (A)÷ (B)	

1/ Attach details of allocation. That is, what rate was used and how the rate was determined.

PERSONNEL COSTS

Direct Labor

Direct labor cost is that portion of wages or salaries which can, as a practical matter, be identified with and charged only to a specific product or service (final cost objective). As stated in the Cost Accounting Standard Board's promulgations, costs are either direct or indirect only. Accordingly, labor costs similar to those treated as direct for the cost estimate must also be considered as direct costs of other final cost objectives and not included in an indirect cost pool. Conversely, no final cost objective shall have charged to it as a direct labor cost a portion of any labor costs the remainder of which is included in an indirect cost pool.

Labor shall be classified as direct when:

a. it is essentially directly related to the product or service;

b. the labor cost can be measured with reasonable effort; and

c. the labor cost is not insignificant.

Direct labor costs are composed of two factors: the first is the time it takes to do the job, and the second is the rate(s) of pay for the labor skills required. These two factors are equally important and each must be estimated as precisely as possible. For this reason, they are treated separately in the following paragraphs.

In estimating the time required to perform a service or produce a product, the starting point is the statement of work. A thorough review of the work requirements should definitize the outputs requiring labor. The time required to perform these outputs can be estimated by utilizing prior experience if it is available, engineered standards, or engineering estimates. If similar jobs have been completed, the direct labor hours of those jobs may be used as a basis for subsequent job estimating, provided appropriate adjustments are made for any scope and procedural changes. Also, when estimating the direct labor hours, include all on-the-job training which involves productive work. Time spent on all other training will be treated as indirect labor and included in the appropriate overhead pool. See OPERATIONS OVERHEAD, and GENERAL AND ADMINISTRATIVE EXPENSES.

Normally, time requirements will be expressed in man-hours. These man-hours can be converted to man-years, by dividing the total man-hours required by either the total number of working hours in a year (i.e., 52 x 40 or 2,080) or by the number of hours normally worked in a year (i.e., 2,080 less leave and holiday time). It is important to know how the man-years were developed to determine whether the labor rate to be applied to the time estimate should be increased to provide for leave and holidays to be earned and taken by the workers. If the time estimate includes a provision for leave and holidays, the rate by which such a time estimate is to be multiplied should not be increased to provide for these costs, and vice versa. Additional comments in this regard are contained in the following paragraphs dealing

with the rate of pay to be applied to the time estimates and in the examples at the end of this section.

When the number of hours of each type of labor are identified, they must be multiplied by the approprate hourly rate in order to arrive at an estimate of direct labor costs. The skill requirements determined to be needed for arriving at the time estimates will dictate the basic rates to be used. Normally, the skills required will specify a Wage Board (WB) or General Schedule (GS) level. When computing costs for an existing Government activity, use the actual rates for current employees. For positions that are not occupied, or for a proposed new start, use salary step 4 for GS positions and wage step 2 for Wage Board positions.

Wage Board rates are normally expressed as hourly rates. These are called the basic hourly rates and will be applied to all hours worked and to all hours of annual leave earned, and sick, holiday and other leave taken to ascertain the total pay of a Wage Board employee. If night and/or environmental differential pay will be required, these differentials should also be included in the direct labor cost for Wage Board employees. Premium pay for Federal civilian firefighters and law enforcement officers is also to be included. Excluded are bonuses, allowances, overtime, and holiday pay.

General Schedule rates are normally expressed as annual rates of pay. Night and post differentials are excluded from this annual rate for GS employees. In order to convert this annual rate to an hourly rate comparable to that of a Wage Board employee, it must be divided by 2,080 hours. Neither the basic hourly rate nor the annual rate contain a provision for leave and holidays.

Based on Civil Service Commission data, a factor of 20% of basic hourly or annual pay has been developed to estimate the amount of annual leave earned and sick leave, holiday, and other leave taken. In computing direct labor costs, this factor must be used. As indicated earlier, the factor may be applied to either the basic labor rate or the productive time estimate. Because of this, care must be taken that the 20% factor not be included in or excluded from both. The following decision diagram illustrates the proper rate to be applied to the time estimate.

TIME ESTIMATE REPRESENTS	LABOR RATE TO USE
Estimated hours required to do the job.	Basic hourly rate increased by the factor for leave and holidays (i.e., base pay x 120%).
Estimated hours required to do the job, plus the allowance for leave and holidays (i.e., actual hours x 120%).	Basic hourly rate.
Estimated hours to be worked for a year plus leave and holidays to be taken.	Annual rate, or basic hourly rate x 2,080.

The detail necessary to support the estimate of direct labor costs will be a listing of the various labor skills required, the number of hours and rates of pay for each job or component contained in the statement of work as illustrated in Figure 3.

FIGURE 3

DIRECT LABOR REQUIREMENTS

(Examples of Typical Entries)

Line Item	Skill Required	Req. Hrs.	Basic Hourly Rate	Hourly Rate Based on Annual Salary	Annual Salary	Total Cost W/O Leave & Holiday Required Hours X Applic. Rate	Total Annual or Periodic Labor Costs**
Repair Electric Meters	Electrician W/B-4	200	$11.00	$ -	$	$2,200.00	$ 2,640.00
Install Meter Mounts	Carpenter W/B-3	100	11.50	-		1,150.00	1,380.00
Install Water Coolers	Carpenter's Helper	100	7.00			700.00	840.00
Inspection	Inspector GS 9/2	100	-	7.21 ($15,000 ÷ 2,080 hours = $7.21)		721.00	865.20
Reliability Improvement Engineering	Engineer GS 12/2	1 Man Year*	-	-	23,000	-	$23,000.00**

* Includes leave and holiday but excludes other fringe benefits.

**Annual salary already includes leave and holiday.

Fringe Benefits

Fringe benefits are allowances and services provided by the Government to its employees as compensation in addition to the wages or salaries used in determing the basic hourly rate or the annual rate of pay. For purposes of estimating the cost of a Government operation, fringe benefits will include only the normal, recurring benefit costs attributable to an on-going operation. Costs such as termination and separation allowances of Government personnel displaced by a contractor operation are not fringe benefits but rather are to be included as Termination Costs in comparing Government costs and contractor costs. Employee relocation allowances provided to Government personnel shall be included in Government start-up or termination costs, as applicable, when associated with the opening or closing of a Government-operated activity.

The following guidance has been developed to facilitate estimating fringe benefits applicable to the basic hourly pay and the annual rate of pay of General Schedule and Wage Board employees. In cases where certain employees receive fewer or additional benefits, special computations will be needed.

In determining direct labor costs, leave and holiday time is considered as being included. Therefore, they are not included in fringe benefits. Premium pay for working on holidays is discussed under "Additional Benefits."

Standard Fringe Benefit Factors. Government-wide percentage factors shall be applied to annual or periodic labor costs (C above) to determine the following fringe benefit costs:

Retirement and Disability (for employees under Civil Service Retirement)	20.4%
Health and Life Insurance	4.0%
Other Benefits (including work disability, unemployment programs, bonuses and awards, etc.)	1.9%

Additional Benefits. For Government civilian employees (normally temporary employees) who are not under the Civil Service Retirement System, the Social Security (FICA) cost factor to be applied to salary or wage costs is the actual employer contribution rate for the employees involved. When

estimating the FICA cost, care must be exercised to assure that the FICA rate is applied only to wages and salaries subject to the tax. Information regarding FICA tax rates and minimum salaries and wages to which they are applicable should be obtained from the appropriate personnel office.

If the Government employees whose time is included in the cost estimate will receive allowances for off-site pay, location allowances, hardship pay, hazardous duty pay, uniform allowances, incentive pay, cost of living differential, night differential for General Schedule employees, etc., an estimate of the actual costs thereof will be used to develop individual rates for the local area. Information needed to compute rates involved should be obtained from the cognizant personnel or payroll office. Where allowances are not uniformly distributed among all local personnel, it may be necessary to compute separate rates or amounts for individual employees or employee groupings such as General Schedule employees and Wage Board employees.

Overtime premiums and premium pay for working holidays are not included as an additional benefit. Overtime and holiday premiums are either "other direct costs" or "indirect costs." In either case, they are not included in the determination of additional benefits nor in the total annual or periodic labor costs. Overtime and holiday premiums are direct costs only when it is known that the work required to provide the product/service being estimated must be performed on overtime. Otherwise, overtime and holiday premiums are indirect costs since the incurrence of overtime provides equal benefit to all work scheduled. Night and environmental differentials are considered additional benefits for General Schedule employees, but are included in the annual or periodic labor costs for Wage Board employees. Fire fighters and law enforcement officers' premiums are also included in the annual or periodic labor costs.

Documentation. The backup material for the amount shown as fringe benefits applicable to direct and indirect labor shall be a detailed summary of each fringe benefit, supported by a schedule showing the computation of each fringe benefit cost. The computation schedule should include the base costs to which fringe benefit factors are applied and their source, as well as the rate factors and their source. Normally, a single fringe benefit factor may be used. However, if significant differences exist in their composition, different fringe benefit rates will have to be calculated separatelty for direct labor costs and for indirect cost pools. A sample schedule is shown in Figure 4.

FIGURE 4

FRINGE BENEFITS

Annual or Periodic Labor Costs

	SUBJECT TO RETIREMENT1/	SUBJECT TO FICA UNDER LIMIT	SUBJECT TO FICA OVER LIMIT	TOTAL	FRINGE BENEFIT AMOUNTS
DIRECT LABOR	$6,800,000	$170,000	$30,000	$7,000,000	
INDIRECT LABOR					
MATERIAL OVERHEAD	1,980,000	17,000	3,000	2,000,000	
OPERATIONS OVERHEAD	2,984,000	16,000	-	3,000,000	
GENERAL & ADMIN-ISTRATIVE EXPENSE	4,000,000			$ 4,000,000	
TOTAL	$15,764,000	$203,000	$33,000	$16,000,000	
RETIREMENT AT 20.4% of $15,764,000					$3,215,856
FICA at 6.05% of $203,000					13,195
HEALTH, LIFE INSURANCE AND OTHER BENEFITS AT 5.9% of $16,000,000					944,000
TOTAL STANDARD FRINGE BENEFITS					$4,173,051
ADDITIONAL FRINGE BENEFITS LIST AND EXPLAIN					1,906,949
TOTAL FRINGE BENEFITS					$6,080,000

CALCULATION OF FRINGE BENEFIT RATE

TOTAL FRINGE BENEFITS ÷ TOTAL ANNUAL OR PERIDOIC LABOR COSTS = $\frac{\$\ 6,080,000}{\$16,000,000}$ = 38%

ENTRY ON COST COMPARISON

LINE 4 - $7,000,000 DIRECT LABOR x 38% = $2,660,000

LINES 2, 5, AND 7 - THE FRINGE BENEFITS TO BE INCLUDED IN THE OVERHEAD POOLS (38% of $2,000,000; $3,000,000 AND $4,000,000, RESPECTIVELY) ARE INCLUDED IN THE TOTAL SHOWN ON THESE LINES.

1/ See Subchapter S.14, "Computation of Annunities," Federal Personnel Manual.

OPERATIONS OVERHEAD

General

Operations overhead is one of the three classifications of indirect costs. The other two, material overhead and general and administrative expense, are discussed in separate sections. This section deals only with operations overhead.

Definition

Operations overhead costs are the indirect costs of an annual fiscal period which are necessarily incurred to produce or deliver the products/services being provided by a particular organizational element (hereinafter referred to as a work center). Operations overhead differs from material overhead costs which are related only to acquiring, handling, and storing material, and from general and administrative expenses which are those costs whose incurrence benefits all the activities of the organization of which the particular work center is a part.

For practical reasons, some minor costs are treated as indirect costs even though a direct cost relationship can be determined. Short-term work efforts and small, inexpensive items of material generally fall in this category. They should be included in the overhead pool which is most closely related to the nature of the costs; i.e., material overhead, operations overhead, or general and administrative expense. It is important, however, that all costs incurred for the same purpose in like circumstances be treated as either direct costs only or indirect costs only with respect to the final cost objectives (i.e., the product or service being provided by the work center).

Estimating Operations Overhead Costs

Step One. The first step in estimating operations overhead costs is to determine the work center(s) which will perform the work necessary to provide the product/service being estimated. Once this determination is made, all of the estimated costs related to the elements of expense of that work center must be classified as either direct or indirect costs. (Refer to the applicable sections for each element of expense.) The following table illustrates the final result of such a classification.

TOTAL ESTIMATED COSTS TO BE INCURRED BY WORK CENTER "A" DURING FISCAL YEAR 197X

Direct Costs		$9,000,000
Indirect Costs		
Operations Overhead	$4,500,000	
Material Overhead	-0- *	
General & Administrative Expense	-0- *	
Total Indirect Costs		4,500,000
Total Annual Costs		$13,500,000

* While it is possible to incur some of these types of costs in Work Center "A", for purposes of this illustration it is assumed that none will be.

Step Two. The summary amount of operations overhead shown in the illustration in Step One represents the total costs of the individual types of expenses involved. To arrive at this amount, it is necessary to estimate the amount of the individual types of expenses. As a general rule, where the product or service is to be provided by an existing work center, historical records of the amounts and types of indirect costs incurred by it will be available. These historical records may be used as the basis for developing an estimate of the indirect costs to be incurred during the period in which the product or service is to be provided. They should be adjusted to reflect inflation and any other changes in staffing or operations contemplated by management. If the product or service being estimated represents a new start, the statement of work will be the fundamental document on which the estimate will be predicated. Once the requirements of the statement of work are determined, it may be possible to find a work center within the organizational structure that is similar to the one required. The indirect costs of that similar work center, appropriately adjusted, would be an acceptable basis for developing the estimate of the costs of the individual elements of expense. If neither an existing nor similar work center is available, then the annual amounts of the individual items of indirect costs necessary to accomplish the statement of work should be estimated in consultation with cognizant management and technical personnel.

Types of Operations Overhead Expenses

A description of the more common types of operations overhead expenses are discussed in the following paragraphs.

Indirect Labor - This category includes all personnel costs of the work center not considered as direct labor, material overhead, or general and administrative expense, as defined in the sections dealing with those costs. The costs of supervision and administration within the work center, as well as the costs of the time of direct employees not spent in productive effort or on leave (e.g., idle time, training, etc.) should be included. Care must be taken to assure that indirect labor costs that are more appropriately classified as material overhead or general and administrative expense are not included in the operations overhead. Indirect labor costs should include all applicable fringe benefit costs (see Figure 2). Estimates of and supporting documentation for indirect labor should be prepared in much the same way as for direct labor. Essentially, positions required by the work center identified as providing the product/service are identified and designated as direct or indirect. Once the designation is made, it must be consistently followed. The salaries and wages of the indirect employees are estimated for the year(s) being studied.

Indirect Materials and Supplies - Included in this category are those items of material or supplies utilized by the work center in its operations but which are not chargeable as direct materials as defined earlier in this chapter. Examples of such items are lubricants and rags for equipment, or common use low-cost fasteners, such as wire, staples and screws. The costs of indirect materials and supplies should include their allocable share of material overhead. Estimates of indirect materials and supplies are determined in much the same manner as those for direct materials. The prices for these types of materials and supplies are estimated and total indirect material and supply costs determined.

If it is not practical to list each single item of indirect material and supplies in the documentation supporting the estimated amount, they may be aggregated into logical subgroupings and shown in total and a reference made as to where the detail can be examined. If the amounts of indirect material and supplies are estimated in some other way than by a detailed listing, a clear explanation of the method used to arrive at the estimated amount must be contained in the supporting documentation.

Depreciation - Depreciation is the method utilized to spread the cost of tangible capital assets (plant, machinery, etc.) less residual value, over their estimated useful lives in a systematic and logical manner. Note that because land has an unlimited life, it is not a depreciable asset and its cost should not be included with other asset costs that are subject to depreciation. The cost of a tangible capital asset includes the original acquisition cost plus the transportation and installation costs incurred to place the asset in use. Additions need to be added and retirements deleted to keep the costs current. Useful life has reference to the estimated period of economic usefulness of the asset in a particular operation as distinguished from its physical life. Determination of the asset's useful life should be based on actual or planned retirement and replacement practices. An asset that is still in use should not be reflected as being fully depreciated. To avoid this happening, the estimated useful lives need to be reviewed and adjusted periodically to conform to current plans. Residual value is the estimated value of the asset at the end of its useful life. Because useful life and physical life may differ, the residual value is not always equal to scrap value. Both the useful life and residual value should be estimated, based on historical records and in consultation with engineering and management personnel. For purposes of this Handbook, depreciation will be computed on a straight-line basis. That is, an equal amount of the difference between the acquisition cost of the asset and its residual value should be charged to each accounting period or unit of usage covered by its useful life.

For example, if an asset costs $1,000 and had a residual value of $100 and a useful life of 10 years, $90 should be charged to each year's operation during its useful life ($1,000 - $100 = $900 ÷ 10 years = $90/year).

If depreciation is to be based on hours of usage, the difference between the cost and residual value would be divided by the estimated number of hours the machine will be used during its useful life to arrive at an hourly depreciation rate. The amount of depreciation to be included in the operations overhead pool would be the product of the number of hours that the machine will be used during the year, multiplied by the hourly rate previously described, as illustrated below

Acquisition Cost	$1,000
Residual Value	-100
	$ 900
Estimated usage during useful life	5,000 hours
Depreciation Rate ($900 ÷ 5000 hours)	$ .18/hour
Estimated usage during year	500 hours
Depreciation to be included (500 hours x $0.18 hour)	$ 90

The annual depreciation related to all the tangible capital assets (building, plant, equipment, etc.) used by the work center in providing the product/service being estimated will be included in the work center operations overhead costs.

The indirect cost pool (material, operations, or general and administrative expense) to which it is assigned will depend on the use made of the assets.

Supporting documentation for the estimated amount of depreciation should be a detailed listing of the assets involved and the annual depreciation related to each. Where, because of the magnitude of the assets involved, it would not be practical to prepare such a list, the amount of depreciation may be supported by a listing of logical groupings by type of assets and reference made to where the detailed supporting property records may be examined. If depreciation is estimated on other than an item-by-item basis, a complete explanation of the methology used must be included in the supporting documentation.

Rent - This is a cost incurred for the use of a non-Government entity's tangible assets (land, plant and machinery, etc.) in providing the product/service being estimated. All such costs anticipated to be incurred during a fiscal year encompassing the period of performance should be included in the operations overhead pool unless the assets are used in connection with only one product/service. In the latter case, the rental amounts will be treated as a direct cost of that product/service, provided that the rental amounts of similar assets are treated consistently for all other products/services. The amount of rent and the charges included must be determined. If the rent includes a separate charge for maintenance and repair, utility charges, etc., and the amount is significant, those charges should be included in their proper expense classification, if they do not benefit all products or services in the same proportion as the rental charge.

The cost of Government ownership of an asset will normally be included under depreciation and other ownership accounts. However, where a Government-owned asset is "rented" by one Government organization, from a different Government organization, only the actual costs of ownership should be recorded as cost. If the rental amount is predicated on the market rental value, or an incremental cost basis, there may be a significant difference between the rental amount and the cost of ownership. If the rental amount to be included in the estimate represents a GSA-billed Standard Level Users Charge (SLUC) and are in excess of $50,000 annually, a determination of this difference will be made. The difference will be either added or subtracted from the "rental" costs to bring them to the actual costs to the Government. If the rental costs are based on incremental costs, the difference will be determined regardless of their amounts. If it is impractical to arrive at actual Government ownership costs by consultation with the Government lessor, a reasonable estimate of ownership costs will be included.

Maintenance and Repair - The normal costs incurred during a fiscal year for maintaining and repairing the tangible capital assets utilized by the work center providing the product or service being estimated (but not those properly classified as material overhead or general and administrative expense) will be included in the operations overhead cost pool. These costs relate only to those maintenance and repair activities that are necessary to keep the buildings and equipment in operating condition. The costs of major overhauls and repairs which add value or prolong the life of the asset should be treated as capital expenditures and depreciated over the extended or remaining useful life of the asset. The methodology used to estimate of all these costs should be contained in the supporting documentation.

Support Costs - This category includes those indirect costs incurred during the fiscal year by other organizational elements in support of the work center in which the product/service being estimated is to be performed. For example, motor pool services in support of the products or services provided by the work center would be includable in operations overhead. Support costs applicable to material overhead or general and administrative expense should not be included in operations overhead (e.g., ADP services

involving material inventory or general management information), but should be included in those accounts.

Supporting documentation for these costs should indicate the service involved and the performing organization. If significant in amount, the organization supplying the support should estimate the costs in accordance with the provisions of this Handbook and provide the estimate and supporting documentation to the recipient work center for inclusion in its estimate. If the amount is not considered significant enough to warrant preparation of an estimate as described above, the methodology used to arrive at the estimate must be clearly stated in the supporting documentation.

Utilities - This category includes charges for fuel, electricity, telephone, water and sewage services, etc. The amount of these costs applicable to the work center will be determined either on a metered or allocated basis of consumption. Proration of the amounts to the various overhead pools will be by a unit of measure that would vary directly with consumption; e.g., floor space, number of telephones, etc. Estimates of these expenses to be incurred for fiscal years encompassing the period of performance should be based on current experience appropriately adjusted for anticipated future experience. Engineering estimates should be used when experience data are not available. All estimates should be appropriately documented in supporting detail.

Insurance - Operation of any government activity involves risks and potential costs from fire and casualty losses and from liability claims. These risks are normally covered by insurance in the private sector, but the Government is primarily self-insured and must pay for such losses as incurred. Casualty losses have been estimated at .05% of the value of Government facilities, equipment, and material; liability losses at .07% of personnel costs. For a simplified estimate of insurance costs, use .06% of the sum of lines 1 through 4 plus the net book value (acquisition cost less depreciation accumulated to date) of all depreciable assets.

Overtime and Premium Pay - The amounts of overtime and other premium pay to be included as indirect costs in the operations overhead pool are those incurred in order to complete all work of the work center in a timely manner. The reason for considering the overtime or other premium portion of the salaries and wages as an indirect cost is that the scheduling of work effort is usually done on a random basis. That is, the actual work performed during overtime hours or on holidays is usually no more the basis for incurring the premium payments than the effort performed during the regularly scheduled hours. Accordingly, under these circumstances, all work performed in the work center should receive a proration of the premium costs. This is accomplished by including these costs in the overhead expense pool.

The straight time portion of such wages will be considered as Direct Labor as indicated under that section of this Handbook. If the premium pay is necessitated not by an overloading of the work center's normal capacity, but by the special demands of a single customer or client, the related premium costs should be considered as Other Direct Cost for the product or service furnished that customer or client.

Supporting documentation for the amount of overtime and other premium pay included in the indirect cost pool should indicate how the need for such payments was determined and how the amount was computed.

Other Costs - The indirect costs previously discussed are examples of the principal common types of costs which, if applicable, may be entirely or partially included in operations overhead. If further guidance is required on some unique element of cost, the cognizant accounting office should be consulted.

Developing Overhead Rates

Allocation Base - Determination of the amount of the annual operations overhead cost to be applied to the product/service being estimated requires establishment of an appropriate base for allocation of costs. Where the product/service being estimated represents the total output of the organization for the year, all of the operations overhead costs are applcable. However, where more than one product or service is provided during the year, an allocation must be made between these products and/or services. This is normally done by determining and applying an overhead rate. Overhead rates can be expressed as a percentage of one or more elements of expense; e.g., 20% of direct labor or 15% of total direct costs. Overhead rates can also be expressed as a monetary unit related to some quantitative measure; e.g., $2.00 per direct labor hour, $3.00 per machine hour, $0.50 per square foot of space used.

To illustrate the above, assume that Work Center "A" provides three products/services entitled A-1, A-2, and A-3, and a cost comparison analysis is being prepared for A-3. The following additional facts are to be assumed;

- That 300,000 direct labor hours are incurred annually on the three products/services, as follows:

A-1	150,000	
A-2	90,000	
A-3	60,000	
Total	300,000	labor hours

- Direct labor costs for the year are $3,000,000.

- 50,000 machine hours are used to provide the three products/services.

A-1	5,000	
A-2	5,000	
A-3	40,000	
Total	50,000	machine hours

Overhead Rates - Using these assumptions as well as those shown for Work Center "A" in Step One, the following overhead rates (and many others) can be developed:

Percentage of Direct Labor Costs

$$\frac{\text{Operations Overhead}}{\text{Direct Labor}} = \frac{\$4,500,000}{\$3,000,000} = 150\%$$

Percentage of Direct Costs

$$\frac{\text{Operations Overhead}}{\text{Total Direct Costs}} = \frac{\$4,500,000}{\$9,000,000} = 50\%$$

Rate Per Direct Labor Hour

$$\frac{\text{Operations Overhead}}{\text{Direct Labor Hours}} = \frac{\$4,500,000}{300,000} = \$15.00 \text{ per Direct Labor Hours}$$

Rate Per Machine Hour

$$\frac{\text{Operations Overhead}}{\text{Machine Hours}} = \frac{\$4,500,000}{50,000} = \$90.00 \text{ per Machine Hour}$$

As can be seen from the above, there are several ways of developing overhead rates. Rarely will the various rates result in the identical allocation of overhead costs to the services/products provided by the work center. Accordingly, the selection of the proper base of allocation is of extreme importance in costing product/service A-3.

A straightforward way to select the best allocation base is to chart operations overhead costs and various possible allocation bases over time. The allocation base that varies most frequently in the same direction at the same time as the operations overhead costs would be the best allocation base.

As long as it can be ascertained that indirect costs vary directly with a measure of an element of expense or activity (dollars, hours, etc.) and that all products or services furnished by the work center benefit from the same elements of expense or activity, and in the same proportion, the use of that single element as the allocation base will normally result in an equitable distribution of overhead costs. Assuming direct labor hours meet this criterion for Work Center "A," operations overhead would be allocated to the three products/services as follows:

Product/ Service	Direct Labor Hours (1)	Operations Overhead Rate Per Direct Labor Hour (2)	Overhead Allocation (1) x (2)
A-1	150,000	$15.00	$2,250,000
A-2	90,000	15.00	1,350,000
A-3	60,000	15.00	900,000
	300,000	$15.00	$4,500,000

A single base of allocation will normally not be warranted in a work center where:

- The indirect costs do not vary directly and proportionately with a single measure of expense or activity, or

- all elements of expense and activities which influence the incurrence of operations overhead costs (e.g., direct labor influences supervision, etc.) are not incurred in roughly the same proportion for the various products/services provided.

When these conditions are encountered, there are two possible solutions. The first would be to subdivide the work centers into departments and develop a separate operations overhead for each. In that case, development of the departmental operations overhead would be identical to the development of the operations overhead rate(s) for Work Center "A", as described herein. The second solution is to develop two or more overhead rates within the work center by grouping the indirect expenses in overhead pools related to the disparate functions and allocating them on appropriate bases. Obviously, the bases of allocation will not be the same.

We can illustrate the use of two rates for Work Center "A" using the assumptions previously cited. From these assumptions, it can be seen that product/service A-3 is responsible for most of the machine hours used by the work center. Specifically:

A-1 uses 5,000 machine hours;

A-2 uses 5,000 machine hours;

A-3 uses 40,000 machine hours.

Accordingly, direct labor hours would not be an appropriate allocation base because it would result in a disproportionate amount of machine shop expenses (depreciation, maintenance and repair) being allocated to products A-1 and A-2. Conversely, the use of machine hours would result in an inequitable share of the labor-related indirect expenses being allocated to product/service A-3.

Two pools for Work Center "A" may be established by segregating machine-related costs from the other operations overhead as follows:

Basic Pool	$1,500,000
Machine Pool	3,000,000
Total Operations Overhead	$4,500,000

It is determined that the best allocation base for the basic pool is direct costs and the rate is:

$$\frac{\text{Basic Pool}}{\text{Direct Costs}} = \frac{\$1,500,000}{\$9,000,000} = 1/6 \text{ or } 16.67\%$$

Then, the $9,000,000 direct costs are determined to be charged to each product as follows:

A-1	$4,500,000
A-2	2,700,000
A-3	1,800,000
Total	$9,000,000

Therefore, the allocation of the $1,500,000 in the basic pool is:

A-1	1/6 of $4,500,000	=	$ 750,000
A-2	1/6 of $2,700,000	=	450,000
A-3	1/6 of $1,800,000	=	300,000
			$1,500,000

It is also determined that the best allocation base for the machine pool is machine hours and the rate, $60 per machine hour (machine pool $3,000,000 ÷ 50,000 machine hours). Taking the machine hour usage previously determined and this rate, the allocation is:

A-1	5,000 hours at $60	=	$ 300,000
A-2	5,000 hours at $60	=	300,000
A-3	40,000 hours at $60	=	2,400,000
			$3,000,000

Combining the two pools gives us the total allocations:

	Basic Pool	Machine Pool	Together
A-1	$ 750,000	$ 300,000	$1,050,000
A-2	450,000	300,000	750,000
A-3	300,000	2,400,000	2,700,000
Total	$1,500,000	$3,000,000	$4,500,000

The following comparison of the resultant overhead allocation by using a single rate based on direct labor hours and the two rates as illustrated above highlight the significant differences that can be achieved by utilizing different overhead allocation methods.

	One Rate (Direct Labor Hours)	Two Rates (Basic and Machine)	Difference (Substract One from Two)
A-1	$2,250,000	$1,050,000	$(1,200,000)
A-2	1,350,000	750,000	(600,000)
A-3	900,000	2,700,000	1,800,000
Total	$4,500,000	$4,500,000	$ -0-

Summary

In summary, operations overhead is a significant cost element in estimating the cost of providing a product or service. It is extremely important that elements of indirect expense included in the operations overhead pool are appropriate and the amounts thereof are carefully estimated. It must be determined by careful study whether more than one pool of expenses is required. Also, the selection of a proper base(s) for allocation is essential to accurate estimating. As illustrated above, significant differences can result from the use of different methods for allocating overhead. The choice of the appropriate method should be based on a review of the functions and their related costs within the work center. The pools and bases should be selected based on supported facts and circumstances. They should not be selected on the basis of arbitrary assumptions, or the fact that the data for a particular base are readily available. The main purpose of the overhead rate must always be kept in mind. It is developed to permit the allocation of overhead expenses to the products/services being provided on the basis of the benefits they receive from the incurrence of the cost.

Supporting Documentation

The supporting documentation needed for the amount of operations overhead allocated to product/service A-3 will be a listing of the expenses included, the base used to develop the rate(s), and the supporting detail for each. Figure 5 is an illustration of the operations overhead costs of Work Center "A."

FIGURE 5
WORK CENTER "A"
COMPUTATION OF OPERATIONS OVERHEAD RATE
FOR THE YEAR 197x

Operations Overhead Expenses	Basic	Machine	Total
Indirect Labor			
Supervision	$ 70,000	$ 300,000	$ 100,000
Clerical	700,000	300,000	1,000,000
Indirect Time of Direct Personnel	400,000	600,000	1,000,000
Indirect Materials and Supplies	30,000	370,000	400,000
Depreciation	40,000	400,000	440,000
Rent	10,000	50,000	60,000
Maintenance and Repair	40,000	385,000	425,000
Support Costs	10,000	65,000	75,000
Utilities	60,000	610,000	670,000
Insurance	10,000	20,000	30,000
Other			
Allocations Costs	127,000	168,000	295,000
Minor Direct Costs	3,000	2,000	5,000
TOTAL OPERATIONS OVERHEAD (A)	$1,500,000	$3,000,000	$4,500,000
Allocation Bases (B)			
Direct Costs		$9,000,000	
Machine Hours		50,000	
Overhead Rate (A)÷(B)=(C)	16.67% of Direct Costs	$60 Per Mach. Hour	
Application to Product/ Service A-3			
Direct Costs Applicable To A-3 (D)	$1,800,000		
Machine Hours Applicable To A-3 (D)		40,000	
Amount of Operations Overhead Allocated to A-3 (C)x(D)	$ 300,000	$2,400,000	$2,700,000

INTERAGENCY SUPPORT

In developing the estimates of Government costs, products or services which are excess to the needs of other Federal agencies should be used in preference to new procurements. The agency that will be providing the excess product or service must prepare cost estimates in accordance with this Handbook and furnish its cost data on lines 1 through 9 and its other considerations on lines 23 through 30 of the Cost Comparison Form. The Form must be signed on the "prepared by" and "audit certification" lines. The Cost Comparison Form will be submitted to the agency receiving the product or service. The receiving agency will classify the providing agency's costs as other direct costs, operations overhead, or general and administrative expense as appropriate. The other considerations will also be added to the appropriate classification. The providing agency's Cost Comparison Form will be used as supporting documentation. NOTE: Agency reimbursement charges for providing the product or service to another agency may not be used as a basis for the cost estimate unless such charges reflect all costs as provided in this Handbook.

If a decision to contract out would cause the government not to utilize available excess facilities, material or service capacity, any resulting increase in cost to the government must be included as an element in computing the total cost of contracting for the product or service. For guidance in developing and documenting such costs, see the section under OTHER CONSIDERATIONS titled, "Utilization of Government Capacity."

OTHER DIRECT COSTS

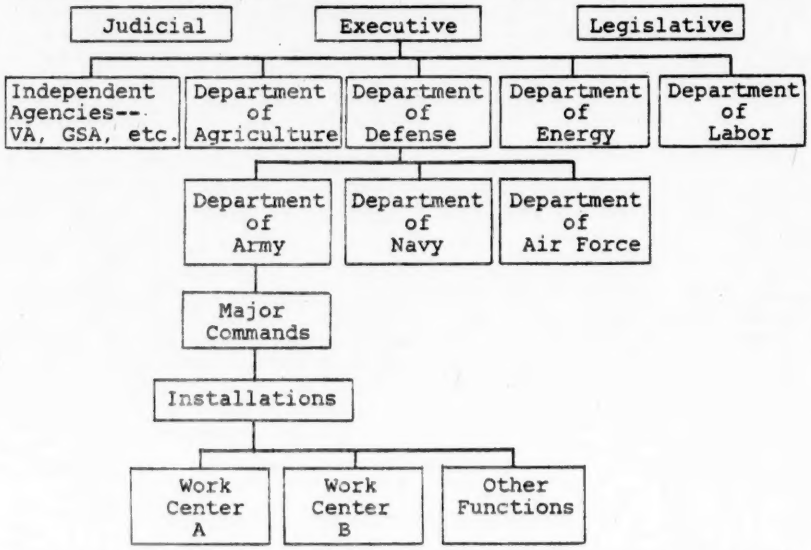
Other direct costs are the sum of all those direct costs exclusive of direct material and direct labor, which are identified as having been incurred specifically for a particular product or service (the final cost objective). Some examples of other direct cost are: service center charges (e.g., ADP service center, printing shop, etc.), travel, and purchased services.

There are certain types of effort that some organizations treat as indirect expense and others classify as direct. Examples of these costs are special travel expenses, preservation, packaging and packing, plant rearrangement, consultant's fees, certain clerical salaries, shop supplies, transportation costs, plant protection, royalties, computer expenses, and telephone and telegraph expenses. Whenever an organization decides to classify a cost as direct it normally will be included under Other Direct Cost unless it is direct material or direct labor. When an organization decides to reclassify a cost from an indirect to a direct charge, it is necessary to ascertain that the organization's accounting and estimating practices provide consistent treatment of these special costs during the period under review. To prevent duplication, it must be established that when these items of expense are treated as direct costs, similar costs are excluded from indirect costs applied to the estimate. Conversely, when an organization reclassifies a cost from direct to indirect, care must be taken to include these costs in the appropriate indirect costs pool.

Refer to the DIRECT LABOR and DIRECT MATERIALS sections of this handbook for cost estimating instructions and supporting documentation requirements which are appropriate for estimating and documenting other direct costs.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative (G&A) expenses are those financial, management or other expenses which are incurred for the benefit of an organizational unit as a whole. They do not include expenses which should be classified as material or operations overhead expenses which have been discussed previously in this Handbook. Because of their nature, general and administrative expenses may be incurred at various levels within the Governmental structure. The following simplified diagram depicts the various levels within the Government where G&A expenses may be incurred:



By looking at the above organization structure, it can readily be seen that certain administrative expenses incurred by the executive, legislative or judicial branches of the Government are applicable to the various departments and independent agencies. Similarly, certain administrative expenses incurred at the department level would be applicable to the activities in their organization (e.g., Departments of Army, Navy, and Air Force). This flow would continue on down to the organization level.Within the organization itself, general and administative expenses may be incurred which are applicable to all the functions being performed there. This flow-down of G&A expenses will vary based on the organizational structure of each department or agency, but will exist in some form in each. A portion of the general and administrative expenses incurred above the installation level are applicable to the product or service being estimated. However, for purposes of this Handbook, only those G&A expenses which contribute directly to the actual operation of the organization will be included in the estimate. This decision is based on materiality of amount and the conclusion that the efforts involved in funding, policy-making, long-range planning, direction, etc. (commonly referred to as staff functions) would continue and be equally applicable to either contractor or Government effort.

In deciding at what level to discontinue the allocation of G&A expenses to the product or service to be provided, a self-sufficiency criterion should be used. A self-sufficient organization is one that operates as an independent unit, receiving only funds, policy direction, and guidance from the next higher organizational unit. If any general and administrative-type activities are provided at no cost or on an incremental cost basis, the organization is not self-sufficient. In these circumstances, an appropriate allocation of the applicable expenses of the incurring organization, should be included in the recipient's G&A expenses to be allocated to the products and/or services it provides.

To illustrate, assume the organization we are concerned with is a laundry. If that laundry is located on its own land, does its own maintenance, budgeting, accounting, etc., it can be considered self-sufficient and no further G&A costs will be allocated to it from the next higher organizational unit. The G&A costs incurred by the laundry itself will be allocated to the various products or services it provides. However, if that laundry was collocated on the same grounds or in the same building of another organization, say a hospital, and the hospital staff provides it with certain maintenance, budgeting and accounting effort, on a no-cost or incremental cost basis, then the laundry would not be self-sufficient. The applicable portion of the hospital's G&A expense must be allocated to the laundry. Assume further that the hospital to which the laundry is attached is located on a military base and the hospital receives certain support from the base, such as road and parking lot maintenance, security, fire protection, etc. If the hospital receives these services on a no-cost or incremental cost basis, it is not a self-sufficient unit. The allocable

portion of the costs incurred by the base that benefits the hospital should be included in the hospital's G&A expenses and an equitable amount thereof allocated to the laundry. For purposes of this illustration, we will assume that the military base is self-sufficient (they all are not); that is, it receives only funding, policy direction, and guidance from its next higher level of command. Accordingly, none of the G&A expenses incurred by the next higher level of command would be allocated to the military base.

In addition to the self-sufficiency criterion, materiality of amount must be kept in mind in determining the level above which G&A expenses will not be considered in the estimate. When the costs involved are minor in amount and their ultimate allocation to the product or service is not likely to have a bearing on the decision to contract-out or perform in-house, they may be excluded if not readily available.

The G&A rate to be used to allocate the organization's G&A expenses to its activities will be developed in much the same manner as the operations overhead rate was developed. That is, a pool of annual G&A expenses will be developed and the total divided by the allocation base.

A significant difference between general and administrative expense rate development and that for operations overhead is that G&A expenses must be accumulated in a single pool. This differs from the operations overhead where certain circumstances may require the establishment of more than one pool. The reason that only one G&A pool of expenses will be needed is the nature of G&A expenses. As previosuly stated, G&A expenses are incurred for the benefit of the organization as a whole. If an incurred expense does not meet this criterion, it should not be included in the G&A pool.

Typical examples of the types of cost to be included in the G&A expense pool are the expenses connected with the following offices or functions:

The Office of the Organization Director (Commander)
The Office of the Comptroller
The Office of the General Counsel (Judge Advocate)
Centralized Personnel Services
Centralized Administrative Services (Adjutant General)
Centralized Procurement
Public Relations
Internal Review (Audit)
Security

To develop a G&A expense pool, the costs associated with each of the functions incurred for the benefit of all products/service provided must be estimated. The cost of performing each function is the total of the expenses (indirect labor, indirect material, etc.) incurred for that purpose during the year. The nomenclature for the types of expenses to be included in G&A overhead pool are similar to those included in operations and material overhead. The characteristic which distinguishes these three types of overhead costs, one from the other, is the purpose for which it was incurred. Accordingly, the G&A pool will be made up of elements of expense similar to those for operations overhead in nomenclature but which are related to performing functions and services such as those performed by the offices listed above. The methods of estimating the amounts of these costs will be the same as those described in the Operations Overhead section and are not repeated here.

Since all G&A expenses must be incurred for the benefit of the organization as a whole, the base used to allocate these costs to the final cost objectives must be representative of the overall operations of the organization. For this reason, the total costs incurred (exclusive of G&A expenses) has been chosen as the allocation base. This base should include the cost of all the mission functions of the organization whether these are commercial, industrial or governmental functions. If, because of the use of this base, the G&A expenses allocated to any final cost objective are significantly different from the benefits it received from their incurrence, a special allocation of G&A expenses to that final cost objective should be made. The amount of the G&A expenses so allocated should be removed from the pool and the costs of the final cost objective, exclusive of G&A, should be removed from the base.

The following steps depict the development of a G&A rate:

Step 1: Develop the G&A expense pool

General and Administrative Expenses

Executive, Professional, Technical, and Supervision Salaries	$1,450,000
Clerical and Other Salaries	1,175,000

Other Expenses (Training, Depreciation, Indirect Materials, Allocated Support Costs, etc.)	3,100,000
Total G&A Expenses	$5,725,000

Step 2: Develop the Base of Allocation (costs incurred by Organization A, exclusive of G&A expense)

Direct Costs	$42,500,000
Operations Overhead Costs	8,900,000
Material Overhead Costs	100,000
Total Cost Incurred Exclusive of G&A Expenses	$51,500,000

Step 3: Develop the Organizational G&A rate (divide the pool by the base)

$$\frac{\$\ 5,725,000}{\$51,500,000} = 11.12\%$$

To estimate the amount of the annual G&A expenses applicable to the product or service being estimated, the above developed rate will be applied to the total estimated annual cost (exclusive of G&A) of providing the product or service as illustrated below:

Direct Material	$ 450,000
Material Overhead	5,000
Direct Labor	1,000,000
Fringe Benefits	250,000
Other Direct Costs	50,000
Operations Overhead	1,500,000
Subtotal	3,255,000
General & Administrative Expense ($3,255,000 x 11.12%)	361,956
TOTAL COST	$3,616,956

The detail required to support the amount of G&A expense allocated to the product or service being estimated will be a listing of the expenses related to the functions and offices classified as general and administrative expenses. The amount to be included in the pool is the annual amount of the G&A expense expected to be incurred during the year(s) in which the period of performance is encompassed. These amounts will be predicated on past experience, adjusted to provide for inflation and any change in operations. If the period of performance occurs in more than one fiscal year, a separate G&A rate will be developed for each fiscal year in which a portion of the performance will take place. For instance, if a service is to be provided for 18 consecuritve months beginning on October 1, 197X, two rates will have to be developed. The rates will be applied to the estimated cost of the service provided in each fiscal year. The base of allocation will be the total estimated cost (exclusive of G&A) expected to be incurred by the organization in each fiscal year. The supporting detail for each year will indicate the source of the estimates and where supporting documentation can be found.

INFLATION OF OUT-YEAR COSTS

In preparing the Government's estimate, all known or anticipated increases in costs to be incurred in the first year of operation should be provided for in each element of cost, as stipulated by the instructions contained in this Handbook. For all subsequent years, anticipated changes in scope of work may be added but no inflation factors will be added to the individual elements of cost. Rather, an amount equal to 4% of the preceding year's total cost (adjusted for any scope changes) will be added to each subsequent year's costs. These amounts will be entered on line 8 of the Cost Comparison Form under the appropriate year.

For example, if the first year's costs on line 9 are $150,000, then the amount on line 8 in the second year will be $6,000 (4% of $150,000); assuming there is no change in other cost elements, the amount on line 8 in the third year will be $6,240 (4% of $156,000), etc.

CHAPTER V - DEVELOPING AN ESTIMATE OF CONTRACTING-OUT COSTS

This section of the Handbook deals with the determination of the cost to the Government of acquiring the product or service being analyzed by letting a contract. It includes determination of not only the amount to be paid to the contractor (contract price) but also the related in-house costs that will be incurred by the Government as a result of contracting out. The cost comparison form (Exhibit 1) identifies the following categories of Government cost which might be incurred in connection with contracting out:

Contract Price
Transportation
Contract Administration
Government-Furnished Property
Standby Maintenance
Other Costs
General and Administrative Expense (on the above)

Comments on each of these categories are contained in the following paragraphs.

CONTRACT PRICE

The contract price included in the cost comparison must be supported by a firm bid or proposal. The contractor's bid or proposal must be predicated on the same statement of work utilized in preparing the Government's estimate. Also, the solicitation for bids or proposals will notify the bidders or offerors that a comparison will be made between the cost of contracting the effort and performing it in-house.

In determining the amount to be recorded as the contract price, consideration must be given to the contract type. The following guidance is provided in this regard.

a. In the case of an advertised firm fixed price contract, the price of the low bidder or offeror will be entered without adjustment. If a firm fixed price contract is to be negotiated, the negotiated low bid price will be entered.

b. When fixed price contracts with flexible pricing arrangements are contemplated; e.g., fixed price incentive fee, the target price of the apparent low bidder or offeror will be entered.

c. If a contract with an award fee is proposed, the performance level comparable to that attributed to Government employees in preparing the Government's estimate will be used to estimate the amount of the fee. The estimated award fee, plus the contract costs of the apparent low bidder or offeror will be entered.

d. If a time and material or labor-hour contract is proposed, the estimated total cost of performance may be calculated and entered. Alternatively, comparable rates can be developed for the Government cost estimate and the comparison can be made on the basis of rates, rather than total costs.

e. If a cost reimbursement-type contract is required by special circumstances, the apparent low bidder or offeror's estimated costs must be subjected to a meticulous technical and cost evaluation to assure that the estimated costs are neither over nor understated. Adjustments to the bidder or offeror's estimate need to be reviewed with the bidder or offeror before the adjusted contract price is entered.

TRANSPORTATION COST

The Government may incur transportation costs whether a product/service is provided by an in-house operation or by a contractor's operation. Transportation for an in-house operation is normally associated with the applicable overhead. This section deals with the cost to the Government for transportation provided in connection with a product/service obtained by contract.

The contract documents or negotiation memoranda will indicate the additional transportation that is to be furnished by the Government. These items are usually clearly indicated. There may be some transportation in addition to that spelled out in the contracts which require an estimate. The best source for obtaining estimates of the cost of this transportation is the local transportation or purchasing office.

Typical of the transportation costs that may be incurred by the Government are:

a. Cost of transporting a contractor's employees;

b. Cost of transporting Government material, equipment, or supplies to and from a contractor's site, such as:

- Cartage cost from airport, bus, rail or marine terminals;
- The cost of special equipment, like refrigerated vans or heated containers;
- The cost of demurrage on rail cars or detention charges for trucks;
- In exceptional cases, the cost of special insurance.

The supporting documentation for these costs should describe the transportation to be provided, the mileage and/or rates utilized in arriving at the estimates, and the source from which they were obtained. If transportation costs were derived in some way other than by extending applicable mileage and rates, the methodology used to arrive at the estimate should be fully explained.

CONTRACT ADMINISTRATION

Contract administration includes the costs incurred by the Government in assuring the contract is faithfully executed by both the Government and the contractor. In addition to reviewing contractor performance and compliance with the terms of the contract, contract administration consists of processing payments, negotiating change orders, and monitoring close-out of contract operations.

The costs of contract administration will be determined by applying four percent (4%) to the contract price, line 10. The result will be entered on line 12 as the cost of contract administration.

GOVERNMENT-FURNISHED PROPERTY

When Government property is furnished to a contractor in connection with the performance of a contract, the cost connected with its use must be considered in determining the overall cost of the contract. Government-furnished property includes (1) that property that is in the possession of, or acquired directly by, the Government and subsequently delivered or otherwise made available to the contractor, and (2) property acquired by a contractor in accordance with the terms of the contract that does not become a part of the end item or is not consumed during contract performance and title thereto vests in the Government. Examples of Government-furnished property are land, buildings, facilities, equipment, special tooling, materials, and supplies.

The methods for determining the costs related to furnishing Government property will vary with the use made of the property. Where Government property becomes a part of the end product (material) or is consumed in providing a product or service (supplies) the full cost to the Government of acquiring and furnishing these materials and supplies must be added to the cost of contracting. When property such as land, buildings, facilities, equipment, and special tooling are provided for the contractor's use during the performance of the contract but will be returned to the Government upon contract completion, the costs of ownership of these assets by the Government during the period of contract performance, plus any other costs incurred in connection with furnishing the property to the contractor must be added to the cost of contracting. More specific guidance is contained in the following paragraphs. The sum of the costs for Government-furnished materials and supplies and for Government-furnished facilities, in accordance with these paragraphs, will be entered on line 13 of the Cost Comparison Form.

Government-Furnished Materials and Supplies

Government-furnished material and supplies (GFM&S) is property which may be incorporated into or attached to a product/service to be delivered under a contract and those supplies which may be consumed or expended in the performance of a contract. It includes, but is not limited to, such items as raw materials, parts, subassemblies, components, and manufacturing supplies. Care must be taken to exclude the cost of any material and supplies that are included in the contract price.

The instructions for estimating the costs of GFM&S are identical to those for estimating the cost of in-house material and supplies. Therefore, the sections of this Handbook entitled, "DIRECT MATERIALS" and "MATERIAL OVERHEAD" should be referenced for guidance in estimating the cost of GFM&S. See the section entitled, "TRANSPORTATION COST," for instruction on the treatment of costs that are associated with transporting GFM&S to and from the contractor's site.

The supporting documentation for GFM&S shall include a detailed listing of all the items to be furnished with

quantities, unit prices, suppliers, details of adjustments and the source of the information. See Figure 1 in the MATERIALS section of this Handbook for an illustration of the supporting documentation requirement.

Government-Furnished Facilities (Buildings and Other Land Improvements) and Equipment

The costs applicable to facilities and equipment furnished to contractors by the Government must be added to the cost of contracting out for purposes of Circular A-76 comparisons. These costs consist of depreciation of capitalized equipment or facilities, or the full expense of minor items of equipment which do not meet agency capitalization criteria. Depreciation on Government-furnished facilities and equipment shall be computed in accordance with the instructions on computing depreciation contained in the Handbook section entitled, "OPERATIONS OVERHEAD." Only the depreciation costs applicable to the proposed contract period will be considered for purposes of the cost comparison.

When the Government rehabilitates, modifies, or expands existing Government-owned facilities or equipment for the purpose of providing it to a contractor as Government-furnished property, the related costs will be treated as follows:

a. If the rehabilitation, modification or expansion of the Government facilities or equipment increases the useful life of the assets to the Government or the asset value of the property, the related costs shall be amortized over the remaining useful life of the assets. The amount to be included in the Circular A-76 cost comparison as an add-on to the contract cost shall be limited to the cost amortization applicable to the period covered by the proposed contract.

b. If the rehabilitation or modification work consists primarily of plant rearrangement, minor repairs, or other work which does not extend the useful life of the assets or does not increase the value of the property to the Government, the related costs shall be considered as additional costs of contracting out. The entire cost of such rehabilitation or modification will be charged to the first year of contract operations or spread over the contract period depending on the period the costs are determined to benefit.

c. While the acquisition cost of land is not depreciable, the costs of any improvements or alterations made to land utilized in performance of the contract, such as landscaping, special grading, etc. should be accumulated and amortized over the estimated useful life of the improvements or alteration. The add-on to the contract cost will be limited to the cost amortization applicable to the period covered by the proposed contract.

Cost estimates will be supported by a summary listing of all the above types of cost and the location of the detailed records used to determine them as follows:

Government-Furnished Facilities and Equipment

		Amount	Source
Depreciation			
Land Improvements	$ XXX		
Buildings	X,XXX		
Equipment	XX,XXX		
		$XX,XXX	
Other Expenses			
Plant Rearrangement	X,XXX		
Minor Repairs	XXX		
Other	XXX		
		X,XXX	
Total		$XX,XXX	

Supporting data should include details on original cost, residual value, annual depreciation, etc., of the equipment and facilities.

STANDBY COSTS

When equipment and/or facilities must be held in standby status to assure contract performance, the cost of holding them must be added to the contract price. Costs related to holding equipment and facilities for any other purpose are not standby costs for purposes of this Handbook, and should not be added to the contract price. Standby costs are defined as expenses necessary for the upkeep of property in standby status which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient, operating condition or available for possible use in performance of the contract.

Standby cost is not to be confused with UTILIZATION OF GOVERNMENT CAPACITY or DISPOSAL OF FIXED ASSETS. Each of these factors is discussed separately in Chapter VI of this Handbook. Normally, Government property is disposed of or put to other use when a decision is made to obtain a product or service from the private sector instead of continuing to produce it in-house.

If it is determined that it is necessary to hold Government property in a standby status, all related costs must be estimated for inclusion in the cost comparison analysis. The estimate of standby costs begins with a determination of the facilities and/or equipment that will be placed in a standby status to support a commercial procurement action. The next step is to estimate the cost, if any, of preparing the facilities and equipment for standby status. The cost of holding the facilities or equipment in a standby status must also be estimated in order to determine the total standby maintenance cost which would result from a commercial procurement versus in-house production. These costs may be estimated by utilizing engineering estimates, prior experience, or experience of other organizations. If similar standby costs have been inccured previously, these may be used as a basis for subsequent costing provided appropriate adjustments have been made for facilities, equipment, and pricing variations. When computing the depreciation cost of property in standby status it will be necessary to review the useful life of the property since useful life may be increased by the change from production to standby status. This review will be necessary even if the depreciation is based on machine hours usage because, while wear and tear may cease, obsolescence may continue.

When the estimated standby cost is determined, as described in the previous paragraph, the total of this cost will be entered on line 14 of the Cost Comparison Form. Backup data must be included for all the cost elements associated with preparation for and maintenance in standby. See Chapter IV of this Handbook for cost estimating instructions, types of cost elements to be included, and documentation requirements. Since Government property is normally disposed of or put to another use when a product/service is procured from the private sector, a detailed justification is required for holding the Government property in standby status.

OTHER COSTS

This cost category encompasses any additional Government costs which would result from commercial procurement and which are not covered elsewhere in the cost comparison. This cost category is included to provide for unusual circumstances which may be encountered in particular cost comparisons.

Supporting data will include a complete description of the costs involved, together with cost detail as outlined for the various cost elements in Chapters IV and V of the Handbook.

GENERAL AND ADMINISTRATIVE EXPENSE

The general and administrative (G&A) expense applicable to the in-house effort related to contracting for a product or service must be included as part of the cost of contracting out. The amount of such expenses to be included will be determined by applying the G&A rate developed in Chapter IV to the total costs of the in-house effort (the sum of lines 11 through 14).

CHAPTER VI - OTHER CONSIDERATIONS

Up to this point, the Handbook has been concerned with determining the cost to the Government of acquiring a product or service either by contracting-out or by in-house performance. The decision as to which alternative to follow will not necessarily be made on the basis of the costs of providing the product or service developed in accordance with Chapters IV and V. Additional costs and other factors may have to be considered to determine the most economical of the two methods.

In order to make an informed decision, the full impact of the two alternatives on the overall cost of Government operations must be known. This will require the decision-maker to evaluate the following:

- o Loss of opportunity to employ resources in other areas if performed in-house (cost of capital);
- o The one-time costs that will be incurred to start or terminate a Government operation;
- o The impact on remaining operations of contractingout a portion of a work center's effort (utilization of Government capacity);
- o Loss of revenue (Federal taxes) due to in-house performance;
- o Any other impact of contracting-out or in-house performance that can be quantified.

Comments on the determination and application of the amounts related to the above are contained in the following paragraphs.

COST OF CAPITAL

The cost of capital is defined as an imputed charge on the Government's investment in all of the plant facilities and other assets necessary for the work center to manufacture products or to provide services. For purposes of simplifying the comparisons required by this Handbook, a distinction is being made between those assets which will be retained and those that will be disposed of if the product or service is contracted out. However, as will be noted below, all of the required assets will be considered. Determination of the amount applicable to those assets that are to be retained, regardless of whether or not the product or service is contracted out, will be determined in accordance with the provisions of the following section entitled, "DETERMINATION OF THE COST OF CAPITAL FOR RETAINED ASSETS." The amount applicable to those assets to be disposed of if the product or service is contracted out will be determined in accordance with the section entitled, "DISPOSAL OF FIXED ASSETS." Basically, the imputed charge for the cost of capital is an opportunity cost; that is, if the capital had not been devoted to the production of the current period, it could have been devoted to another use which would have provided other income or avoided interest expense; it is not an attempt to recover interest on borrowed money.

Determination of the Cost of Capital for Retained Assets

When assets are to be retained by the Government, there are four possible reasons therefor. The first and most obvious reason would be to provide the product or service being estimated by in-house effort. The second reason would be that they are to be provided to the contractor in order to perform the contract. The third reason would be that they must be held to assure performance in the event of a significant contract interruption or delay. The fourth reason is a need for the Government to retain the industrial or commerical capability to meet possible future contingencies. If the assets are retained for any of the first three reasons, consideration of the opportunity cost related thereto must be given in making the cost comparison. It is to be noted that some of the same assets may be retained for any of the first three reasons. The reason for retaining such assets governs whether the cost of capital related thereto will be added to the in-house or contracting-out effort. Since the fourth reason is not germane to the question of contracting out or in-house performance, no cost comparison consideration will be given to the Government's ownership of those assets.

In order to estimate the cost of capital, it is necessary to obtain the net book value (acquisition cost less depreciation accumulated to date) of each tangible capital asset (land, improvements, buildings, equipment, etc.) which is to be retained. The acquisition cost of land and the net book value of each depreciable tangible asset should be obtained from the accounting records. However, if the accounting records are unavailable, it will be necessary to

utilize engineering estimates, prior experience, or experience of other organizations. The cost of capital will be computed by applying an opportunity cost rate of 10% to the total net book value of the assets to be retained. If the assets involved are used solely to provide the product or service being estimated, the total amount of the cost of capital will be added. If the assets involved are used not only to provide the product or service being estimated, but other products or services as well, a proration of the cost of capital will be made.

Prorating Cost of Capital - If the cost of capital were a real rather than an imputed cost, it would be properly classified as a General and Administrative (G&A) expense. Accordingly, its proration to the product or service being estimated will be in the same proportion that the total estimated costs to be incurred (less G&A expense) for the product or service being estimated bears to the total estimated cost to be incurred (less G&A expense) for the performing organization. This latter amount is the base for allocation of the G&A expenses and should be readily obtainable from the supporting documentation. An example of this computation is shown below:

From the illustration in the G&A EXPENSE section of this Handbook the following data are obtained:

Total costs incurred (less G&A expenses) for the product/service being estimated	$ 3,255,000
Total costs incurred in Organization A (less G&A expenses)	51,500,000
Assume total annual cost of capital for assets required	250,000

Then cost of capital applicable to the product or service being estimated would be computed as follows:

$$\frac{\$\ 3,255,000}{\$51,500,000} \times \$250,000 = \$\quad 15,800$$

Assigning Cost of Capital -- After the cost of capital for retained assets is determined, amounts must be assigned, as appropriate, to the cost of in-house performance and the cost of contracting out.

a. In-house Performance -- In the case of assets retained because they are required for in-house performance, the entire amount of the cost of capital for those assets (or the pro rata share when appropriate) will be added to the cost of in-house performance by entry on line 18 of the Cost Comparison Form.

b. Contract Performance -- Assets retained in connection with contract performance may include one or both of the following:

1. Assets retained in order to provide them to a contractor for use in contract performance.

2. Assets retained by the Government to assure provision of the product or service in the event of interruption of contract performance.

The total cost of capital for any assets retained for 1 and 2 above must be considered as costs of contracting. The total of these amounts will be entered on line 23 of the Cost Comparison Form.

Supporting Documentation -- Supporting documentation for the cost of capital related to the assets to be retained shall include a detailed listing of such assets and the net book value of each. If these assets have been previously listed in connection with the computation of depreciation, a reference may be made to that listing rather than duplicating it. Where, because of the magnitude of the assets involved, it would not be practical to prepare such a list, the assets may be supported by a listing of logical groupings by types of assets and reference made to where the detailed supporting property records may be examined.

Disposal of Fixed Assets

When a product/service is being performed in-house by Federal employees, a decision to contract that operation may eliminate the need for all or some portion of the fixed assets used in providing the product or service. The value to the Government of reducing this need must be included as a consideration in the comparative cost analysis. This section deals with those fixed assets which will be disposed of if a decision is made to contract for the product or service.

In determining such costs for consideration in a comparative analysis, the current market value of each of the fixed

assets must be ascertained. If the property is to be disposed of by either GSA or Defense Property Disposal Service, assistance may be obtained from them as to current market value and disposal costs. Also, for equipment items, the market value may be estimated, based on commercial publications which list sales prices of used machinery and equipment of all types. Assistance in this regard may also be available from dealers in the specific equipment for which an estimate is needed.

After an estimate is made of the current market value of the fixed asset to be disposed of, an estimate will be made of the expenses connected with the disposition; i.e., sales commission, advertising, legal fee, relocation, etc. The total expenses related to the disposal will be deducted from the estimated market value to determine the net value to the Government of the fixed asset. Note well: The book value of the asset should not be deducted from the market value to arrive at the net value to the Government. The approach taken in this section precludes the necessity of considering any gain or loss on disposal of the asset.

The net value of each fixed asset will be calculated as described above, and the net value of all fixed assets to be sold will be totalled. This total will be the base for calculating the amount to be included in the comparative cost analysis. The base figure will be multiplied by a factor of 10% representing the annual value to the Government of the amount of the net proceeds. For purposes of this cost comparison, the proceeds that could be realized by disposal of the assets are considered to be a source of additional revenue to the Government. Accordingly, the amount determined from the above calculations is considered as potential revenue to the Government and will be treated as an offset (reduction) to the cost of contracting out and entered on line 28 of the Cost Comparison Form.

ONE-TIME COSTS

In every case where the Government either starts or discontinues an in-house activity it incurs one-time costs resulting from changing the source of the product or service it uses. For new starts, the one-time costs are those associated with establishing the in-house capability and discontinuing a contract arrangement. For conversions, the one-time costs arise from terminating the in-house activity and starting a contract arrangement. Even though these costs are incurred only once and will not recur unless the mode of performance again changes, the total costs may be significant. The significance is measured in relation to the difference between the Government's costs of obtaining the product or service by contract and the Government's cost of in-house performance. The estimated savings to the Government by effecting a proposed new start or conversion must be sufficient to offset the one-time costs over a reasonable time period. As a general rule, a changeover will not be justified on the basis of a cost comparison unless the total one-time costs will be recoverable from estimated savings within five years.

Guidance for determining one time costs for new start and conversion situations is contained in the following paragraphs.

One Time Costs Related to a New Start

While a new start may require substantial new investment by the Government in facilities and equipment, these costs should be annualized in accordance with guidance contained in this Handbook concerning cost of capital and depreciation, and not be included as one-time costs under this section. The costs of acquiring the facility, however, and costs incurred for the acquisition and installation of equipment, unless included in the capitalized cost, would need to be included in one-time cost estimates. Other examples of one-time costs would include office and plant rearrangements, employee relocation expenses, and expenses which are the direct result of discontinuing an existing contract. If a contract is completed, it is not normal that any additional costs will be borne by the Government.

Determination of the full scope of the Government's one-time new start costs should be made in consultation with engineering, production, management, and procurement personnel. Supporting documentation should indicate clearly the type of new start costs anticipated and the methodology used to estimate the amounts to be incurred. The detail supporting the estimate of each element of cost should be similar to that provided for in Chapter IV. For comparison purposes, one-fifth of the total should be added to each year of the cost comparison up to and including the fifth year. The one-fifth figure should be added to the cost of in-house performance by entering it on line 19.

One-Tme Costs Related to a Conversion

When the Government discontinues an in-house activity to obtain the product or service by contract there are usually substantial one-time costs associated with the conversion. These costs are identified and discussed in the following paragraphs.

Material-Related Costs -- A conversion will normally result in certain items of material being held in inventory (either unissued material, work in process, or finished goods) becoming excess. It may be possible to transfer certain of this material to the contractor who is going to provide the product or service in the future. In this case, the material will be treated as Government-furnished material and priced in accordance with Chapter V. In other cases, the material may be diverted to other uses of the Government; in this case, only the additional costs incurred in connection with making the material available for the other use will be included as conversion costs. When neither of the above dispositions of the material is practical, the material will normally be disposed of by sale. If it is anticipated that the material will be sold, the estimated gain or loss on the sale must be considered in determining conversion costs. The estimated gain or loss will be computed by deducting from the estimated sales price the acquisition cost of the material plus material overhead (at the rate developed in Chapter IV) and all other expenses related to disposition, such as packing, shipping, etc. If the material is to be disposed of by either GSA or Defense Property Disposal Service, these agencies should be consulted in arriving at these costs. The supporting documentation for such costs should contain a listing of the items and the quantity to be disposed of, their acquisition cost, and the estimated sales price. In addition, all other expenses such as packing, shipping, disposal, etc., should be adequately supported by documentation describing how the amounts were determined.

Labor-Related Costs -- A conversion will also normally result in the incurrence of certain labor-related expenses that are considered one-time costs. These include severance pay, homeowner's assistance, grade pay retention, relocation expenses and retraining expenses. The amount of these expenses should be computed in consultation with management and personnel department employees. Historical data from the agency or from other agencies gathered from similar circumstances should be considered in arriving at the appropriate cost. The supporting documentation should contain appropriate detail and indicate how the various amounts were arrived at.

Other Costs -- A conversion will normally necessitate certain actions that would not be necessary if the activity were to be continued. For example, a special physical inventory may be necessary to ascertain the material (supplies, equipment, small tools, etc.) on hand. The cost of taking such an inventory would be a proper conversion costs. Also, it may not be possible to avoid the continuation of some costs, such as lease or rental agreements for facilities or equipment, beyond the time that they are no longer required. These types of costs are also properly includable as conversion costs. Supporting documentation for such costs should clearly state the purpose for each item of costs, and how the amount thereof was determined.

General and Administrative Expense -- An amount for general and administrative expense must be included. That amount will be determined by applying the G&A rate developed in Chapter IV to the sum of the material-related, labor-related and other costs.

Documentation and Comparison -- The amount for general and administrative expense must be added to the sum of the costs to which the G&A rate was applied to establish the total one-time costs related to a conversion. The detail supporting the estimate of each element of cost should be similar to that provided for in Chapter IV. For comparison purposes, one-fifth of the total one-time costs should be added to each year of the cost comparison up to and including the fifth year. The one-fifth figure should be added to the cost of contracting by entering it on line 25.

UTILIZATION OF GOVERNMENT CAPACITY

The potential impact on a work center of contracting out for a product or service which it currently provides must be taken into consideration before a decision is made. The decision to contract out can result in the work center becoming completely idle, operating at a reduced capacity, or operating at the same or increased capacity.

When the decision to contract out will result in the work center becoming completely idle because no other use of its capacity is planned, its facilities will either be disposed of or placed in a stand-by status. The circumstances under which the costs related to placing assets in a stand-by

status will be considered as an additional cost to contracting out are set forth in the Standby Costs portion of this Handbook. When the assets are to be disposed of, an opportunity cost will be added to the Government's in-house estimate as prescribed by the Cost of Capital section of this Handbook.

When it is planned that the efforts of the work center will not be reduced because the product or service to be contracted out will be replaced by others, consideration should be given to any savings or additional costs to the Government resulting from transferring the replacement products or services. Where the transfer of effort will rsult in the disposal of Government assets related to the replacement product or service or the avoidance of rental costs, these occurrences should be treated the same as if they were happening in the work center which currently provides the product or service being estimated. See the appropriate sections of this Handbook for further guidance in this regard.

Where the decision to contract out will result in the work center(s) operating at less than its present level of utilization, the costs attributable to this underutilized capacity must be determined. In these cases, some overhead costs allocable to the product or service being contracted out may continue. These continuing overhead costs must be absorbed by the remaining in-house activities. The additional amount to be absorbed by the remaining activities is a cost of contracting out.

For purposes of this Handbook, the cost of underutilization will be determined as follows:

Step 1: From the supporting documentation for operations overhead, determine the total operations overhead expense pool(s), the total amount of the base of allocation and the resultant overhead rate. From the example shown in discussing operations overhead, these amounts would be as follows:

	Basic Pool	Machine Pool
Overhead Expense	$1,500,000	$3,000,000
Base of Allocation	$9,000,000	50,000/mach. hours
Overhead Rate	16.67% of direct costs	60/mach. hours

Step 2: Again, from the supporting detail of the Government's estimate, ascertain the amount of the base of allocation applicable to the product or service being estimated. These amounts will then be deducted from the total base of allocation. As illustrated under the Operations Overhead section, the product/service A-3 incurred direct costs of $1,800,000 and 40,000 machine hours. Thus, we would show:

	Direct Costs	Machine Hours
Total Base of Allocation	$9,000,000	50,000 hours
Less:		
Applicable to Product/ Service Being Estimated (A-3)	$1,800,000	40,000 hours
Adjusted Base of Allocation	$7,200,000	10,000 hours

Step 3: In consultation with accounting and management personnel, ascertain the decreases in overhead expenses that can be expected to occur if the product/service is contracted out. Deduct these decreases from the appropriate overhead pool. Assume that, as a result of contracting out, the total basic overhead pool will be reduced by $500,000 and the machine pool by $2,000,000. This would result in the following:

	Basic	Machine
Total Overhead Expense	$1,500,000	$3,000,000
Less Reductions due to Contracting Out	500,000	2,000,000
Adjusted Overhead Pool	$1,000,000	$1,000,000

Step 4: Ascertain the overhead rate to be applied to the remaining effort. The overhead rate will be developed by dividing the adjusted overhead pool developed in Step 3, above, by the adjusted allocation base developed in Step 2, as follows:

	Basic	Machine
Adjusted Overhead Pool (From Step 3)	$1,000,000	$1,000,000
Adjusted Base of Allocation (From Step 2)	$7,200,000	10,000 hour
Overhead Rate (Pool - Base)	13.89%	$ 100 per hour

Step 5: Ascertain the difference between the amount of overhead costs applicable to the effort not to be contracted out in both circumstances. In our illustration, this would be done as follows:

Product/Service Portion of Allocation Base		Basic (Direct Costs)	Machine (Machine Hours)
A-1		$4,500,000	5,000 hrs.
A-2		2,700,000	5,000 hrs.
Total	(A)	$7,200,000	10,000 hrs.
Overhead Rates if Performed In-House (From Step 1)	(B)	16.67%	$60/hour
Overhead Amount if Performed In-House (A) x (B) =	(C)	$1,200,240	$ 600,000
Overhead Rates if Contracted Out (From Step 4)	(D)	13.89%	$ 100/hour
Overhead Amount if Contracted Out (A) x (D)=(E)		$1,000,000	$1,000,000
Increase (Decrease) in Overhead Charged to Remaining Products Due to Contracting Out (E) - (C)		($200,160)	$ 400,000

The increase in cost due to contracting out is the sum of the differences shown above, or $199,840 ($400,000 + ($200,160). This increased cost should be added to the cost of contracting out. The supporting documentation should contain the adjustments made to the overhead expense pool and explain how they were computed.

If the product or service being estimated represents more than 5% of the general and administrative expense allocation base (total costs incurred minus general and administrative expenses), similar computations to those above for operations overhead should also be made for the general and administrative expense rate. Similarly, the impact of contracting-out a product or service on material overhead should be determined if the material content of the product or service is 5% of the total material costs.

FEDERAL TAXES

When comparing the cost to the Government of a product or service to be obtained by contract with the cost of in-house performance, the potential Federal income tax revenues must be considered. Since contract performance would provide the contractor with income subject to tax, an estimated amount for such taxes is an appropriate deduction from the net cost to the Government of acquiring the product or service by contract.

To simplify the tax computation, a table (Figure 6) prepared by the Internal Revenue Service, provides by types of industries, appropriate tax rates in relation to business receipts. The industry groupings conform to the Enterprise Standard Industrial Classification issued by the Office of Management and Budget. To determine the amount of the estimated Federal income tax, the contract price (line 10 of the Comparative Cost Form) shall be multiplied by the tax rate, selected from Figure 6, applicable to the industry identified with the product or service under consideration. The result of this computation will be the estimated amount of Federal income tax to be entered on line 27 as a deduction from the cost of contracting.

Figure 6 ↓

↓ Figure 6 is not available at this present time but will be included in the final document.

OTHER ADDITIONS/DEDUCTIONS

Space has been provided on the Cost Comparison Form by inclusion of lines 20, 21, 26, and 29 for any other additions or deductions to the cost of in-house or contracting-out performance not specifically covered by any of the foregoing classifications of costs. Amounts entered on these lines should be supported by definition of the type of cost, the methods of its computation, and if appropriate, a detailed listing of specific cost elements included therein.

CHAPTER VII COST DIFFERENTIALS

Different cost margins have been established by OMB Circular A-76 that must be exceeded before performing a "new start" in-house, and before converting an in-house activity to a contract. Details pertaining to these cost margins and the methods by which they are to be determined are set forth in the following paragraphs.

New Start

A new start for purposes of OMB Circular A-76 and his Handbook refers to any activity not currently being done in-house at a particular location. When a comparative cost analyis is conducted for a possible "new start", a cost margin equal to 10% of the estimated personnel related costs plus 25% of the estimated cost of ownership of the required facilities and equpment must be added to the cost of in-house performance on the Cost Comparison Form. For this purpose, ownership costs will be considered to be the product's or service's prorata share of the depreciation and cost of capital that are applicable to the required assets.

The margin of 10% of estimated personnel costs is consistent with the margin favoring the status quo in studies of existing Government activities. The additional margin of 25% of the cost of ownership of the required facilities and equipment provides a tangible expression of the basic policy of the Circular; it also recognizes the risks inherent in Government investment in industrial facilities.

The method of computing the cost margin for a "new start" is illustrated in the following steps. Data from the figures provided in the OPERATIONS OVERHEAD and GENERAL AND ADMINISTRATIVE EXPENSE sections of this Handbook as they pertain to Product A-3 will be use to the extent possible. Since these examples do not contain all the data necessary to the computation (e.g., direct labor, and material overhead data) certain additional assumptions pertaining to Product A-3 are necessary. These assumptions and the steps in the computation of the cost margin are shown below:

STEP 1. Determine the amount of direct labor applicable to the product or service being estimated. This will be the amount shown on line 3 of the cost comparision form.

EXAMPLE: For product A-3, this amount is assumed to be $1,000,000 of its $1,8000,000 direct costs. Based on this assumption, the direct labor amount that would be shown on line 3 is $1,000,000.

STEP 2. Determine the prorata share of the indirect labor and depreciation contained in each overhead pool that is applicable to the product or service being estimated. The total indirect labor and depreciation contained in each overhead pool should be readily available from the detail utilized to develop the various overhead rates and which are to be included as supporting documentation.

EXAMPLE: To the extent data were availabe in the examples used in various sections of the Handbook, they have been utilized; otherwise, the assumptions made are stated.

Material Overhead Assume that $600,000 of the direct costs of $1,800,000 shown for Product A-3 in the OPERATION OVERHEAD section represent direct material costs. This would normally be obtained from line 1 of the cost comparison form. Also, assume that in the material overhead pool there are total indirect labor costs of $500,000 and depreciation costs of $100,000; also, ; the total material costs (direct and indirect) in the allocation base are $4,800,000. These data should normally be available from the documentation supporting material overhead. The following computation for Product A-3 then can be made:

a. Determine the rate of Product A03's direct material cost to the total allocation base:

$$\frac{600,000}{4,800,000} = 1/8 \text{ or } 12.5\%$$

b. Apply the above ratio to the total indirect labor and depreciation in the material overhead pool to arrive at the amounts thereof applicable to Product A-3:

Indirect labor, $500,000 x 12.5% = $ 62,500

Depreciation, $100,000 x 12.5% = $ 12,500

Operations Overhead From the illustration in the OPERATIONS OVERHEAD section, the following data are available:

Total indirect labor in Basic Pool	$1,170,000
Total indirect labor in Machine Pool	$ 930,000
Total depreciation in Basic Pool	$ 40,000
Total depreciation in Machine Pool	$ 400,000
Total allocation base (direct costs) Basic Pool	$ $9,000,000
Total allocation base (machine hours) of Machine Pool	50,000 hours
Direct costs of Product A-3	$1,800,000
Machine hours applicable to Product A-3	40,000 hours

The computations for the two pools would be as follows:

Basic Pool

a. $$\frac{\$1,800,000}{\$9,000,000} = 1/5 \text{ or } 20\%$$

b. Indirect labor, $1,170,000 x 20% = $ 334,000
Depreciation, $40,000 x 20% = $ 8,000

Machine Pool

a. $$\frac{40,000 \text{ hours}}{50,000 \text{ hours}} = 4/5 \text{ or } 80\%$$

b. Indirect labor, $930,000 x 80% = $ 744,000
Depreciation, $400,000 x 80% = $ 320,000

SUMMARY

Total indirect labor in operations overhead applicable to Product A-3 = $1,078,000

Total depreciation in operations overhead applicable to Product A- = $ 328,000

General and Administrative (G&A) Expense From the illustrations in the G&A EXPENSE section, the following data are available:

Executive, Professional, and Technical Supervision Salaries $1,450,000

Clerical and Other Salaries	$1,175,000
Total indirect labor	$2,625,000

Total allocation base (total cost incurred, exclusive of G&A) $51,500,000

Assume:

Depreciation included in the $3,100,000 of Other Expenses is	$ 100,000
The total incurred costs, exclusive of G&A, applicable to Product A-3 are	$4,940,000

Then the computation to determine the indirect labor and depreciation in G&A applicable to product A-3 would be as follows:

a. $ 4,940,000 / $51,500,000 = 9.6%

b. Indirect labor, $2,625,000 x 9.6% = $ 252,000
Depreciation, $100,000 x 9.6% = $ 9,600

STEP 3. Accumulate all the labor costs applicable to the product or service being estimated as developed in STEPS 1 and 2:

EXAMPLE:

Direct labor from STEP 1	$1,000,000
Indirect labor from STEP 2	
Material Overhead	$ 62,000
Operations Overhead	$1,078,000
G&A Expense	$ 252,000
Total labor applicable to Product A-3	$2,392,500

STEP 4. Apply the fringe benefits rate developed in accordance with the FRINGE BENEFITS RATE section of this Handbook to the total labor costs developed in STEP 3, above.

EXAMPLE: Assume a fringe benefit rate of 38% has been developed then.
$2,392,500 x 38% = $ 909,150

STEP 5. Combine the amounts developed in STES 3 and 4 to arrive at total personnel related costs.

EXAMPLE: $2,392,500 + $909,150 = $3,301,650

STEP 6. Compute 10% of the amount developed in STEP 5 to determine the personnel related cost margin.

EXAMPLE: $3,301,650 x 10% = $ 330,165

STEP 7. Accumulate the depreciation applicable to the product or service being estimated as developed in STEP 2.

EXAMPLE: Depreciation from STEP 2:

Material Overhead	$ 12,500
Operations Overhead	$ 328,000
General and Administrative Expense	$ 9,600
Total depreciation applicable to Product A-3	$ 350,100

STEP 8. Determine the Cost of Capital that is applicable to the product or service being estimated. The Cost of Capital will be computed in accordance with the applicable section of this Handbook and entered on line 18 of the cost comparison form.

EXAMPLE: Assume the cost of capital applicable to the facilities and equipment required to provide Product A-3 is $ 300,000

STEP 9. Combine the amounts of Depreciation and Cost of Capital developed in STEPS 7 and 8 to arrive at the total ownership costs of the required facilities and equipment.

EXAMPLE: Amounts Applicable to Product A-3

Depreciation	$ 350,100
Cost of Capital	$ 300,000
Total ownership costs	$ 650,100

STEP 10. Compute the ownership cost margin by applying 25% to total ownership costs.

EXAMPLE: $650,100 from STEP 9 x 25% $162,525

STEP 11. Combine the personnel related margin developed in STEP 6 and the ownership margin developed in STEP 10 to arrive at the total cost margin for a new start.

EXAMPLE:	Personnel margin from STEP 6	$ 330,165
	Ownership margin from STEP 10	$ 162,525
	Total cost margin for newstart	$ 492,690

STEP 12. Enter the cost margin developed in STEP 11 on line 31 of the cost comparison form.

CONVERSION

Conversion for purposes of OMB Circular A-76 and this Handbook concerns only the change from in-house to contract performance. The opposite change, that is, from a contract to in-house performance, is considered a "new start" and is covered by the preceding subsection. When a possible conversion is being considered, a cost margin equal to 10% of the in-house personnel related costs must be added to the cost of contracting out on the cost comparsion form. This amount is added to give consideration in the cost comparison to the loss of production, the temporary decrease in efficiency and effectiveness, and other unpredicable risks that result anytime a change is made in the method of operation from in-house to contract. It also takes into consideration the personnel turbulence that results from such a change.

Computation of this personnel-related cost margin is identical to the computation of the personnel-related portion of the cost margin for a new start. Accordingly, the personnel-related portion of STEPS 1 through 6, above, will be followed to compute the cost margin. The resulting amount will be added to the cost of contracting out by entry on line 32 of the cost comparison form.

CHAPTER VIII SUMMARY

Submission of the Government's Cost Estimate

When all the costs connected with in-house performance have been estimated (lines 1 through 9, 18 through 22, and 31, if appropriate), they should be totalled and entered on line 33 of the Cost comparison Form. This will then complete the action necessary to submit the Government's in-house cost estimate. This action should be completed in time for estimate, along with its supporting data, to be submitted to the contracting officer within the prescribed dates for bid or proposal submission. The form should be signed and dated by the person responsible for its preparation in the line entitled, "In-house Estimate Prepared By." If preparation of the form was done by a task force, the Chairman of the task force should sign, indicating that he was the Chairman.

Simplified Cost Comparison When Inhouse Costs Are Below Best Offer

After the contracting officer opens the bids or completes negotiations, he will ondicate in line 10 of the form the lowest responsible bid or proposal. He will then return the form to the preparer for completion. If the contract price that has been entered on line 10 is higher than the Government's in-house cost estimate on line 33, a simplified cost comparison can be accomplished provided the Government's estimate has been properly prepared.

When the annotated contract price (line 10) exceeds the total in-house costs (line 33) it can be assumed that the cost of in-house performance will be less than the cost of contracting-out. This assumption precludes the necessity for completing those portions of the form dealing with the cost of contracting-out. Completion of these portions would only serve to document the net additional costs which must be added to the contract ptice. Since the contract price alrady exceeds the cost of in-house performance, such information would not alter the recommendation. Therefore, there is no need to complete those portions of the form. In these circumstances, the contract ptice entered as line 10 will also be entered on line 34. The ammount by which the cost of in-house performance as shown on line 33 ia under the contract price shown on line 34 will be determined and entered on line 35. The form will then be signed, on the line entitled, "Cost Comparison Completed By,: by the Task Force Chariman or such other individual who was assigned the responsibility.

After the comparison is completed and the Form signed, it will be submitted to a qualified activity independent of the cost analysis preparation to ensure the Government's estimated costs have been prepared in accordance with the provisions of this Handbook. If no, or only minor, discrepancies are noted during the review, the reviewing activity will execute the audit certificate and return the form to the preparer for resubmission to the contracting officer.

If significant discrepancies are noted during the review, they will be reported to the party preparing the cost comparison. The reviewing agency should indicate the impact of the discrepancy or recommend that the preparer correct and resubmit its estimate. If the revised estimate results in the government's costs of in-house performance exceeding the contract price on line 10, a simplified comparison is no longer warranted. The full cost comparison as indicated below must now be performed. As indicated in Chapter III, if the procurement action pertains to a new-start and the estimated cannot be corrected in a timely manner, the in-house figure will be rejected and the contract awarded. Conversely, if the contemplated procurement pertains to an activity presently being performed in-house, and the estimate cannot be corrected within the validity date of the bids or proposals, the procurement action may be terminated and the comparison rescheduled for a later date.

When the cost comparison has been audited and, with any necessary corrections, approved by the reviewing agency, the party responsible for preparing the cost comparison will originate the Decision Summary Form, Exhibit 2, including the recommendation to award a contract or to perform the work in-house. This form and the Cost Comparison Form will be forwarded to the Contracting Officer, who will indicate the action taken to award a contracat or to cancel the procurement action, signing and dating the form where indicated.

Completion of the Cost Comparison Form

When the lowest responible bid or proposal is below the Government cost estimate, the contracting officer will advise the preparer of the Form of the amount of the low bid by inserting it on line 10 of the Cost Comparison Form and returning it for completion. The preparer will then complete lines 11 through 17, 23 through 30, and 32, if appropriate. The amounts on these lines should then be totalled and entered on line 34 of the Form. The amount to be entered in line 35 should then be computed by deducting line 34 from line 33.

After the comparison has been completed, it should be submitted, along with its supporting documentation, to an organization which is independent of the preparing organization for verification. This verification is intended to assure that all the amounts contained on the Form are predicated on the most current data available to the preparer, that the data are accurate and complete, and that it has been prepared in accordance with the provisions of this Handbook. Any discrepancies noted will be treaded in the same manner as indicated in the preceding subsection dealing with Simplified Cost Comparisons. If no discrepancies are noted (or those noted have been corrected), the audit certification will be completed. Any significant discrepancies not corrected will be reported to the preparer and the contracting officer. The prepare will originate the Decision Summary Form, submitting it to the contracting officer with the Cost Comparison Form. Based on the guidance contained in Chapter III, the contracting officer may either disqualify the Government estimate or terminate the procurement action.

When the contractaing officer receives the completed cost comparison with the audit certification and the Decision Summary Form, he will take the appropriate steps to complete the procurement action and indicate it on the Decision Summary Form. When the amount on line 35 indicates that the cost of in-house performance exceeds the cost of contracting-out. Conversely, when it is indicated that the cost of in-house performance is less than (under) the cost of contracting-out, then the recommendation should be to perform in-house.

(DEPARTMENT OR AGENCY)

COMPARATIVE COST OF IN-HOUSE AND CONTRACTING-OUT
PERFORMANCE OF (PRODUCT/SERVICE)

_____
(Date)

LINE #	Cost Element	FIRST YEAR	SECOND YEAR	THIRD YEAR	ADDITIONAL YEARS AS APPROPRIATE	TOTAL	REFERENCE
	IN-HOUSE PERFORMANCE (CHAPTER IV)	(Enter Amounts Rounded to Nearest Dollar)			(NOTE 1)		(NOTE 2)
1.	DIRECT MATERIAL						A
2.	MATERIAL OVERHEAD						B
3.	DIRECT LABOR						C
4.	FRINGE BENEFITS ON DIRECT LABOR						D
5.	OPERATIONS OVERHEAD						E
6.	OTHER DIRECT COSTS						F
7.	GENERAL AND ADMINISTRATIVE EXPENSE						G
8.	INFLATION	Not applic.	_____	_____	_____	_____	H
9.	TOTAL	_____	_____	_____	_____	_____	
	PERFORMANCE BY CONTRACTING-OUT (CHAPTER V)						
10.	CONTRACT PRICE						I
11.	TRANSPORTATION						J
12.	CONTRACT ADMINISTRATION						K
13.	GOVERNMENT-FURNISHED PROPERTY						L
14.	STANDBY MAINTENANCE						M
15.	OTHER COSTS						N
16.	GENERAL AND ADMINISTRATIVE EXPENSE	_____	_____	_____	_____	_____	O
17.	TOTAL	_____	_____	_____	_____	_____	

NOTE 1: If more than four years are involved, use another form(s) to detail the annual cost of each year and enter the total here.

NOTE 2: Attach supporting documentation as prescribed for each element of cost for which an entry is made and identify it with the established reference. Pages should be separately numbered with the prescribed alphabetic reference and in numerical sequence; e.g., A-1, A-2, A-3, etc. The reference column in this column indicates the total number of pages submitted; e.g., A-1 through 14.

Exhibit 1

LINE #	Cost Element	FIRST YEAR	SECOND YEAR	THIRD YEAR	ADDITIONAL YEARS AS APPROPRIATE	TOTAL	REFERENCE
	OTHER CONSIDERATIONS (CHAPTER VI)						
	ADDITIONS AND (DEDUCTIONS) TO IN-HOUSE PERFORMANCE						
	ADD:						
18.	COST OF CAPITAL						P
19.	ONE-TIME NEW-START COSTS						Q
20.	OTHER COSTS						R
	DEDUCT:						
21.	OTHER COSTS	( )	( )	( )	( )	( )	S
22.	TOTAL						
	ADDITIONS AND (DEDUCTIONS) TO CONTRACTING-OUT PERFORMANCE						
	ADD:						
23.	COST OF CAPITAL ON GOV'T'FURNISHED FACILITIES						T
24.	UTILIZATION OF GOVERNMENT CAPACITY						U
25.	ONE-TIME CONVERSION COSTS						V
26.	OTHER COSTS						W
	DEDUCT:						
27.	FEDERAL INCOME TAXES	( )	( )	( )	( )	( )	X
28.	NET PROCEEDS FROM DISPOSAL OF ASSETS (ANNUAL VALUE)	( )	( )	( )	( )	( )	Y
29	OTHER COSTS	( )	( )	( )	( )	( )	Z
30.	TOTAL						
	MINIMUM COST DIFFERENTIAL (CHAPTER VII)						
31.	NEW-START						AA
32.	CONVERSION						BB
	SUMMARY (CHAPTER VIII)						
33.	ADJUSTED COST OF IN-HOUSE PERFORMANCE (LINE 9± LINE 22 + 31)						
34.	ADJUSTED COST OF CONTRACTING-OUT PERFORMANCE (LINE 17 ± LINE 22 + 31)						
35.	COST OF IN-HOUSE OVER (UNDER) COST OF CONTRACTING-OUT PERFORMANCE (LINE 33 - LINE 34)						

IN-HOUSE ESTIMATES PREPARED BY:

(Name) (Date)

(Title) (Telephone)

APPROVED BY:

(Name) (Date)

(Title) (Telephone)

PERFORMANCE RECOMMENDATION (IN-HOUSE OR CONTRACT) APPROVED BY:

(Name) (Date)

(Title) (Telephone)

COST COMPARISON PREPARED BY:

(Name) (Date)

(Title) (Telephone)

AUDIT CERTIFICATION

We have reviewed the above form and substantiated the currency accuracy and completeness of the data. We further verified that the procedures followed were in compliance with OMB Circular A-76 and the related Cost Comparison Handbook.

(Name) (Date)

(Title) (Telephone)

Exhibit 2

DECISION SUMMARY
FOR
IN-HOUSE OR CONTRACT PERFORMANCE
BASED ON
COST COMPARISON PER OMB CIRCULAR A-76

I. Department/Agency _____
Location _____
Function or Activity _____
Currently Performed In-house/by Contract _____

II. Contract Data:
Solicitation date _____ Solicitation No. _____
Number of bids _____ Closing date _____

Contract proposal is for __ year(s) with options for __ year(s).
Cost comparison covered __ years, from _____, 19__ to _____, 19__.
Proposed changeover date _____

III. Total Adjusted Cost of In-House Performance (Line 33) _____

Total Adjusted Cost of Contracting-Out Performance (Line 34) _____

Cost of In-House Performance Over (Under) Cost of Contracting-Out Performance (Line 35 _____

IV. Non-Monetary Considerations (Attach Supplemental Sheets if Necessary)

V. Final Recommendation - Perform In-House _____
Contract Out _____

Prepared by: /s/ _____
(Name) (Date)
(Title) (Telephone)

Approved by: /s/ _____
(Name) (Date)
(Title) (Telephone)

VI. Action of Contracting Officer:
Perform In-House _____ Bidders Notified _____
Contract Out _____ Contract No. _____
Awarded To _____

(Name) (Date)
(Title) (Telephone)

Exhibit 2. Decision Summary Form

APPENDIX

GLOSSARY OF TERMS

The definitions presented below are taken from the text of this handbook, the Cost Accounting Standards, procurement regulations, and other authoritative publications.

ACQUISTION COST. The amount paid to acquire an asset (Chapter IV - Operations Overhead).

ACTUAL COST. An amount based on cost incurred as distinguished from estimated costs. Includes standard cost properly adjusted for applicable variance (Chapter IV - Fringe Benefits).

ALLOCATE. To assign an item of cost or a group of items of cost to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool (Chapter IV, Operations Overhead).

ALLOCATION BASE. The denominator in the fraction used to develop overhead rate. It is either the total of some element of expense (or goup thereof) or a quantitative measure that is common to all items or activities to which the indirect costs are to be allocated (Chapter IV, Material Overhead, Operations Overhead, G&A Expenses).

AMORTIZATION. The gradual extinguishment of any amount over a period of time, such as the write-off of a portion or all the cost of an asset, or the retirement of a debt over a period of years (Chapter V, Government-Furnished Facilities).

AWARD-FEE CONTRACT. A cost reimbursement-type contract with special fee provisions. It provides a means of applying incentives in contracts which are not susceptible to finite measurements of performance necessary for structuring incentive contracts (Chapter V, Contract Price).

BASIC LABOR RATE. For Wage Board employees, the basic labor rate is the hourly rate to be applied to all hours worked and to all hours of annual leave earned, and sick, holiday and other leave taken to ascertain the pay of a Wage Board employee. The General Schedule (GS) basic rate is the published annual rate of pay for the

particular GS grade and step level (Chapter IV, Direct Labor).

BILL OF MATERIAL. A detailed listing of the material requirements for performing a service or providing a product (Chapter IV, Direct Material).

CAPITALIZED COST The cost of acquiring, installing and modifying a tangible capital asset that has been added to an asset account. (Chapter VI, One-Time Costs).

CARTAGE. Transportation from a freight terminal to the point of use or consumption (Chapter V, Transportation).

CONTRACT ADMINISTRATION COSTS. The cost incurred to assure faithful execution of a contract by both the Government and the contractor (Chapter 5, Contract Administration).

CONVERSION. The transfer of work from a Government commerical or industrial activity to performance by a private commerical source under contract (Chapter VI, One-Time Costs).

COST COMPARISON. An accurate determination of whether is is more economical to acquire the needed products or service from the private sector or from an existing or proposed Government commerical or industrial activity (Chapter II, Policy).

COST DIFFERENTIALS. The cost margins established by OMB Circular A-76 that must be exceeded before performing a "new-start" in-house and before converting an in-house activity to a contract (Chapter VII, Cost Differentials).

COST ELEMENT. A basic unit of cost, such as labor or material. The accummulation of all the basic units related to a given product or service provides the total cost of that product or service (Chapter IV, General).

COST OF CAPITAL. An imputed charge on the Government's investment in all of the plant facilities and other assets necessary for the work center to manufacture products or provide services (Chapter VI, Cost of Capital).

COST OF CAPITAL COMMITTED TO FACILITIES. An imputed cost determined by applying a cost of money rate to facilities' capital (Chapter VI, Cost of Capital).

COST REIMBURSEMENT CONTRACT. A type of contract that provides for reimbursement to the contractor of allowable costs incurred in the performance of a contract, to the extent prescribed in the contract (Chapter V, Contract Price).

CURRENT COSTS. Costs incurred in the current accounting period (Chapter IV, Direct Material).

CURRENT MARKET VALUE. The amount for which an item could be sold in today's market (Chapter VI, Cost of Capital).

DEMURRAGE. The compensation paid for the delaying of a ship, freight car, etc., as by the failure to load, unload, or dispatch within the time allowed (Chapter V, Transportation Cost).

DEPRECIATION. The method used to spread the cost of tangible capital assets (plant, machinery, etc.), less residual value, over their estimated useful lives in a systematic and logical manner (Chapter IV, Operations Overhead).

DIRECT COST. Any cost which can be identfiied specifically with a particular final cost objective. Direct costs are not limited to items which are incorported in the end product as material or labor. Costs which can be identified specifically with a product/service are direct costs of that product/service. All costs identified specifically with other products/services are direct costs of those products/services. (Chapter IV, General).

DIRECT LABOR. That portion of salaries and wages which, as a practical matter, can be identified with and charged only to a specific product or service (Chapter IV, Direct Labor).

DIRECT MATERIAL. The costs of such goods as raw material, parts, sub-assemblies, components and supplies which as a practical matter, can be identified specifically with the product/service (the final cost objective) under review (Chapter IV, Direct Material).

DOUBLE-COUNTING. The treatment of certain costs as direct costs of the product/service, while similar costs related to other products/services are treated as indirect costs and a portion thereof is allocated to the

product/service for which the estimate is being prepared (Chapter IV, General).

ESTIMATING COST. The process of determing a future or past result in terms of cost, based upon information available at the time (Chapter IV, General).

FAIR MARKET VALUE. A realistic valuation of what an item could be sold for in open market (Chapter V, General).

FINAL COST OBJECTIVE. A cost objective which has allocated to it both direct and indirect costs, and, in the cost accumulation system, is one of the final accumulation points (Chapter IV, General).

FIRM-FIXED-PRICE CONTRACT. A contract which provides for a price which is not subject to any adjustment by reason of the cost experience of the contractor in performance of the contract (Chapter V, Contract Price).

FISCAL YEAR. The accounting period for which annual financial statements are regularly prepared. The Government's Fiscal Year begins on October 1, and ends on September 30 (Chapter IV, Operations Overhead).

FIXED PRICE CONTRACT WITH FLEXIBLE PRICING ARRANGEMENTS. This type of contract provides for either a firm-fixed-price for an initial period and for prospective price redeterminations at stated times furing the performance of the contract or a ceiling price and retroactive price redetermination after completion of the contract Chapter V, Contract Price).

FRINGE BENEFITS. Allowances and services provided employees as compensation in additon to basic salaries and wages (Chapter IV, Fringe Benefits).

FULL COSTS. The total of all direct and indirect costs allocable to a product or service (Chapter IV, Direct Material).

GENERAL AND ADMINISTRATIVE (G&A) EXPENSE. Any management, financial and other expense which is incurred by or allocated to an organizational unit and which is for the general management and administration of the unit as a whole. G&A expense does not include those management expenses whose beneficial or causal relationship to cost objectives can be more directly measured by a base other than a cost input base representing the total activity of the unit during a cost accounting period. (Chapter IV, General and Administrative Expense).

GOVERNMENT-FURNISHED FACILITIES AND EQUIPMENT. Facilities and equipment in the possession of, or acquired directly by the Government and subsequently delivered or otherwise made available to the contractor (Chapter V, Government-Furnished Property).

INCREMENTAL COST. The increases or decreases in total cost, or the changes in specific elements of cost, that result from variations in operations (Chapter IV, Operations Overhead).

INDIRECT COST. Any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective (Chapter IV, General).

INDIRECT COST (OVERHEAD) POOL. A grouping of incurred (or projected) costs identified with two or more cost objectives but not identified specifically with any final cost objective (Chapter IV, Operations Overhead).

INDIRECT LABOR. All labor that is incurred for the benefit of more than one product or service or the business as whole. It may be included as material overhead, operations overhead, or general and administrative expense (Chapter IV, Operations Overhead).

INDIRECT MATERIALS AND SUPPLIES. Includes items of materials and supplies which are not identifiable to a single product or service but which are necessary to performance of the various functions of an entity. It also includes the minor amounts of direct material for which accounting as direct costs is not practical. (Chapter IV, Material Overhead, Operations Overhead, General and Administrative Expense).

INFLATION. An increase in the amount of money in circulation resulting in a decline in its value and rise in prices (Chapter IV, Inflation of Out-Year Costs).

INSURANCE. The cost to the Government arising from liabilities and losses not covered by insurance. The costs are incurred in consonance with the Government's policy of acting as a self-insurer (Chapter IV, Operations Overhead).

INTERAGENCY SUPPORT. Products or services furnished from the capacity of another Government agency or organization to the agency which will provide the product or service being estimated (Chapter IV, Interagency Support).

LABOR HOUR CONTRACT. A variant of the time and material-type contract, differing only in that materials are not supplied by the contractor (Chapter V, Contract Price).

LABOR-TIME STANDARD. A preestablished measure expressed in temporal terms, of the quantity of labor required to perform a task (Chapter IV, Direct Labor).

MAINTENANCE AND REPAIR Cost incurred to keep buildings and equipment in normal operating condition (Chapter IV, Operations Overhead).

MATERIAL OVERHEAD COSTS. Indirect costs related to an activity or group of activities for acquiring, handling, and/or controlling required materials, until the materials are used or consumed in the production of goods and services or are sold without processing (Chapter IV, Material Overhead).

MATERIAL-QUANTITY STANDARD. A preestablished measure, expressed in physical terms, of the quantity of material required for a specific purpose (Chapter IV, Direct Material).

NET BOOK VALUE. The capitalized cost of an asset or group of assets shown in the accounting records, less accummulated depreciation or other applicable offset (Chapter VI, Cost of Capital).

NEW START. A newly established Government commerical or industrial activity, including a transfer of work from contract to in-house performance (Chapter VI, One-Time Costs).

NO-COST BASIS. The provision of a product or service without charge or remuneration (Chapter IV, General and Administrative Expense).

NOMINAL COST. Cost of a very minor amount (Chapter IV, Direct Material).

ONE-TIME COSTS. The nonrecurring costs to the Government when it either starts or discountinues an in-house activity as a result of a decision to change the source of a product or service (Chapter VI, One-Time Costs).

OPERATIONS OVERHEAD COSTS. The indirect costs which are necessarily incurred during a fiscal year to produce or deliver the products or services being provided by a particular organizational element (Chapter IV, Operations Overhead).

OPPORTUNITY COSTS. Other income, or expense avoidance, foregone by using limited resources for a particular purpose (Chapter VI, Cost of Capital).

OTHER DIRECT COSTS. All those direct costs exclusive of direct labor and direct material which are identified as having been incurred specifically for a particular product or service (Chapter IV, Other Direct Costs).

OVERHEAD RATE. A percentage, or monetary unit related to a quantitative measure, derived by dividing an indirect cost pool by an allocation base. (Chapter IV, General, Material Overhead, Operations Overhead).

OVERTIME AND PREMIUM PAY. Additional amounts added to basic salaries for working longer than the regularly scheduled hours or under unusual conditions. (Chapter IV, Operations Overhead).

PHYSICAL INVENTORY. The actual amount of material on hand (Chapter VI, One-Time Costs).

PRICING. The process of establishing the amount or amounts to be paid in return for goods or service (Chapter IV, Direct Materials).

PROPOSAL. Any offer or other submission used as a basis for pricing a contract, contract modification or termination settlement or for securing payments thereunder (Chapter V, Contract Price).

RENT. The cost incurred for the use of a non-Government entity's tangible assets (land, plant and machinery, etc.) in providing the product/service being estimated (Chapter IV, Operations OVerhead).

RESIDUAL VALUE. The proceeds (less removal and disposal costs, if any) realized upon disposition of a tangible capital asset. It usually is measured by the net

proceeds from the sale or other disposition of the asset, or its fair value if the asset is traded on another asset. (Chapter IV, Operations Overhead).

STANDARD COSTS. Any cost computed with the use of preestablished measures (Chapter IV, Direct Material, Direct Labor).

STANDARD LEVEL USER CHARGE (SLUC). The amount which the General Services Administration (GSA) assesses Federal agencies for thier assigned space in GSA controlled building. This SLUC note is a composite of three ingredients:

a. The fair annual rental appraisal rate for space, utilities and normal services;

b. an escalation of this rate; and

c. an added charge for standard protection.

STANDY MAINTENANCE COSTS. The costs necessary for the upkeep of property held in a standby status to assure contract performance. This maintenance neither adds value to the property nor appreciably prolongs its useful life. Rather, the mainenance keeps the property in an efficient operating condition so that it will be available for possible use in case of nonperformances by the contractor (Chapter V, Standby Maintenance Costs).

STRAIGHT-LINE DEPRECIATION. A method of depreciating an asset by charging an equal amount of its depreciable cost (captialized cost less residual value) to each accounting period covered by its useful life, or by charging an equal amount of its depreciable cost to each hour of use, each product produced, etc. (Chapter IV, Operations Overhead).

SUPPORT COSTS. Costs incurred by one organizational unit for the benefit of another (Chapter IV, Operations Overhead).

SURCHARGE. An additional amount added to the basic charge to cover expenses incurred in providing the products or services. (Chapter IV, Direct Material; Material Overhead).

TANGIBLE CAPITAL ASSET. An asset that has physical substance, more than minimal value, and is expected to be held for continued use or possession beyond the current accounting period.(Chapter IV, Depreciation).

TIME AND MATERIAL CONTRACT. A type of contract which provides for the procurement of supplies and services on the basis of (i) direct labor hours at specified fixed hourly rates (which shall include wages, overhead, general and administrative expense, and profit) and (ii) material at cost and in addition, where appropriate, material handling costs as a part of material cost (Chapter V, Contract Price).

WORK CENTER. The lowest organizational unit at which cost are accumulated (Chapter IV, Operations Overhead).

WORK STATEMENT. A comprehensive description of what is to be done, including performance standards as appropriate. The work statement should describe all duties, tasks, responsibilities, frequency of performance of repetitive functions and requirements for furnishing facilities and materials (Chapter III, Preparation of Work Statement).

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